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Incentives for Litigation or Settlement in Large Tort Cases: Responding to Insurance Company Intransigence

Jay M. Feinman*

The purposes of this article are (1) to describe some ways in which the practices of insurance companies in settlement negotiations and the decision to settle or litigate in large tort cases disserve the objectives of tort law; and (2) to suggest genuine tort reforms to better align the dynamics with the objectives. By "large tort cases" I mean individual cases (excluding mass torts and class actions) in which there is significant personal injury or death to individuals. Typically these are what lawyers would think of as six- or seven-figure damages cases.

I. THE DYNAMICS OF SETTLEMENT AND LITIGATION

Begin with an idealized picture of the tort system. The familiar objectives of tort law are (1) providing incentives for safe behavior and deterring unreasonable, unsafe behavior; compensating the victims of wrongfully imposed harm, and (2) fairness. These objectives are served by imposing liability on wrongdoers and assessing damages at a level that imposes on the wrongdoer the cost of the harm to the victim.

In the overwhelming majority of tort cases, the defendant is insured. Insurance is beneficial. It provides a fund for

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1. See Tom Baker, Blood Money, New Money and the Moral Economy of
compensating the victim that might not otherwise be available because of a judgment-proof defendant. It also often spurs settlement, in part, because it aligns the interest of the victim and the defendant in a prompt settlement within policy limits, particularly in light of the widespread practice under which the victim accepts the policy limits as a limit on damages and does not pursue the defendant for any further compensation.²

In an ideal system, settlement is an effective proxy for litigation, in that either litigation or settlement attaches liability to the proper party and fixes damages in the appropriate amount. Taking the big qualification of putting aside the public values of litigation (such as the establishment of rules to regulate future conduct, the pronouncement of public norms, and the moral vindication of victims), settlement is even preferred to litigation because of its lower transaction costs.³

Against this background, there are two principal models of the dynamics of settlement. The first model views settlement as an economic negotiation in which the principal determinant of the decision to settle is the parties' calculation of the expected value of the claim. The second model suggests that other factors in the bargaining process are as important or more important in deciding whether a case will be settled.

Under the economic model of settlement, parties are assumed to calculate the expected value of the litigation by discounting the ultimate expected award by the probability of success in litigation and factoring in the effect of litigation costs.⁴ When the expected

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². See id. at 314.


⁴. See RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 607-15 (5th ed. 1998); STEVEN A. SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 401-11 (2004); Getting to No, supra note 3, at 323-27; Price Theory, supra note 3, at 629-32. For criticism in addition to that suggested by the bargaining model discussed next, see Robert J. Rhee, The Effect of Risk on Legal
values of the parties overlap, there is an opportunity for settlement. Party error, differences in risk preferences, the stakes of the case, and other factors may make settlement more or less likely, but settlement is largely "a function of transaction cost economics."\(^5\)

The bargaining theory model argues that economic theory does not capture all of the elements that are important in settlement dynamics, and that in many cases elements other than the expected value of the litigation will be more important.\(^6\) These other elements include more pronounced risk preferences of the parties, other differences in how they value the outcome of the litigation, transaction costs and the litigants' ability to bear them, and strategic behavior in the bargaining process.\(^7\) Therefore, an overlap of the parties' expected values is a necessary but not a sufficient condition for settlement.

The bargaining theory model in particular yields predictions about the bargaining situation in large tort cases. In these cases, insurance companies as repeat players face victims as one-shotters.\(^8\) Although the defendant is the nominal adverse party and the defendant is represented by counsel, the insurance company is typically the key player in the settlement and litigation process. Under the liability policy, the insurer assumes the defense of its insured and exerts effective control over the defense counsel through the "commodification" of insurance defense practice.\(^9\) The companies are likely to be hard bargainers,

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5. Price Theory, supra note 3, at 632. Recent empirical work demonstrates that the expected value is not the expected value of a judgment after trial, discounted by probability and litigation costs, but the expected payout, which is usually less than the judgment. David Hyman et al., Do Defendants Pay What Juries Award? Post-Verdict Haircuts in Texas Medical Malpractice Cases, 1988-2003, 4 J. Empirical Legal Stud. 3 (2007) [hereinafter Haircuts].

6. For a summary, see Getting to No, supra note 3, at 327-30.

7. Id. at 328.


in order to establish their reputation and to discourage easy claims. Hard bargaining includes making no or very low offers and being willing to take cases to trial. However, other factors mitigate in favor of settlement. Because of the precedential effects (as legal precedents and as guideposts for future bargaining) and the portfolio effects of very large losses, companies are more likely to settle likely losers and to litigate likely winners.10 Victims are likely to be in need of the recovery in the case, to have less financial staying power and to be involved in only the single case rather than a portfolio of cases; therefore, they are likely to be risk averse and more inclined to settle early for a lower amount.11 The scales are somewhat balanced because victims are represented by lawyers on a contingency fee basis; these lawyers are repeat players and can treat each individual case as part of a portfolio of cases.12 There are numerous conflicts built into this system.13 There is a conflict between the victim and the victim's lawyer, because the lawyer finances the case while most of the benefit of added investment accrues to the client; this conflict is addressed by the rules of professional responsibility and the norms of professionalism that require the lawyer to act in the client's interest.14 There are conflicts among the defendant, the insurance company, and the lawyer hired by the company to represent the defendant. The key conflict for present purposes is between the company and the defendant, particularly in cases in which the potential damages exceed the policy limits. In cases in which the expected value of the litigation exceeds the policy limits, the insurance company has less incentive to settle. This lack of incentive works to the detriment of the insured defendant, who is at least theoretically responsible for the excess,15 and of the

11. Don't Try, supra note 3, at 48-56.
12. Id.
14. MODEL RULES OF PROFESSIONAL CONDUCT MR1.3 (1983)
15. I say "theoretically" because in many cases the victim does not proceed against the defendant for the excess judgment, either because of
victim, for whom the insurance coverage is the only realistic source of compensation.\textsuperscript{16} This conflict is addressed by the law of insurance bad faith, which restricts the ability of the company to subordinate the defendant's interests to its own.\textsuperscript{17}

Summarizing the application of the bargaining models to large tort cases, there are some distortions of the ideal settlement process in favor of the defendant and insurance company, but these distortions are somewhat balanced by the contingency fee system and the law of bad faith. The large stakes relative to the litigation costs and the likelihood of strategic behavior by the insurance company tend to make trials more frequent. However, the potential for large losses by the insurance company, the risk aversion of the victim, and the portfolio management strategy of the victim's lawyer tend toward settlements in the range of expected values, though perhaps at the lower end of that range. The results serve the objectives of tort law moderately well, though far from perfectly. Victims in large cases are somewhat under-compensated and transaction costs are significant, but in many cases victims receive substantial compensation from wrongdoers when insurance companies pay to settle cases and pass the cost of the settlements on to policyholders in the pricing of premiums.

II. THE PROBLEM OF INSURANCE COMPANY INTRANSIGENCE

The problem is that there appears to be a substantial gap between the predictions about settlement in the literature and the practice of settlement in large tort cases. In general, this gap can be described as a failure to appreciate the full consequences of insurance companies' strategic behavior under the bargaining model.

A. The Problem

There are a very significant number of large cases, probably

\textsuperscript{16} Six Ways, supra note 8, at 4-7.

\textsuperscript{17} See ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW 875-906 (1988).
an increasing number in the last few years, in which liability is relatively clear and it is also clear that the victim's damages are substantial, yet the insurance company refuses to make an offer to settle the case, makes a disproportionately low offer that it refuses to raise, or makes an offer only very late in the process.\textsuperscript{18} In the cases in this group that go to judgment, there is often an award in excess of the policy limits. If the company does not pay the excess amount, the defendant (or victim by assignment) must pursue the bad faith action, which is sometimes successful and sometimes not.\textsuperscript{19} Even if the company ultimately pays the entire judgment, the victim has suffered substantial costs for which it is not compensated, such as economic costs incurred because of the delay in payment and noneconomic costs such as additional emotional distress.\textsuperscript{20} The presence of this problem requires readjustment of the theories of settlement and, more importantly, means that the objectives of tort law are being less adequately served than is ordinarily supposed.

It is difficult to document the extent of this practice.\textsuperscript{21} Trial lawyers regard it as widespread; at meetings of trial lawyers at which I have discussed this issue, practically every lawyer reports having encountered the phenomenon. Although their reports are anecdotal, they are persuasive. In recent discussions, for example, one lawyer reported on a case in which the insurance company claims representative announced that "even if a verdict higher than the [multi-million] dollar offer was returned [the company] could delay payment indefinitely with the appellate process and there was no telling when our client would ever see any money." Another reported on "something weird happening" at a major national insurance company, in that it was "almost impossible to


\textsuperscript{19} As a rough approximation, for example, a search of insurance bad faith cases on Westlaw's Verdict and Settlement Summaries database for 2007 produces figures of 175 plaintiff verdicts, 82 defense verdicts, and 27 settlements.


\textsuperscript{21} Kritzer's account of the state of empirical research on defense practice presents it as a significant unknown area. \textit{Defending Torts, supra} note 9, at 46-50.
settle cases with them, forcing litigation in almost every case.” A third lawyer described a similar problem with another major insurer that estimated the amount of claims “under budget, so even with a good liability case, the case never got the attention one would expect until just before trial.

Even defense lawyers report this type of behavior among their insurance company clients:

Another lawyer at [a defense firm] expressed frustration to me after a no-fault arbitration hearing about handling cases where the insurer had no good defense. The lawyer believed that the insurer had made a business decision to fight such cases as a means of deterring certain classes of claims even though the insurer should have known that the claimant who persisted with such a claim would prevail. A different lawyer described a case he was working on as a “virtual sure loser”; in the lawyer’s view the type of case involved could be won only when the claimant would present so poorly that the claimant would have a total lack of credibility.\(^\text{22}\)

Also anecdotal but even more persuasive is the evidence of insurance company intransigence in cases that are reported or described in news reports. What is most striking about this evidence is that it exposes the extent to which insurance companies make a formalized, established practice of this behavior.

Among the most notorious is the “Performance, Planning and Review” system used by State Farm and exposed in the series of punitive damages cases that included the U.S. Supreme Court’s decision in State Farm Mutual Automobile Insurance Co. v. Campbell.\(^\text{23}\) Justice Kennedy delicately “acknowledged” that State Farm’s decision to take a clear case of liability to trial and subject its insured to the likelihood of a judgment in excess of the policy limits “merits no praise.”\(^\text{24}\) The Utah Supreme Court provided more details. In the particular case, State Farm refused several times to settle the case within the policy limits even though its own investigator had concluded there was evidence of

\(^{22}\) Commodification, supra note 9, at 2084.
\(^{23}\) 538 U.S. at 414-15.
\(^{24}\) Id. at 419.
the insured’s fault; instead, State Farm’s divisional superintendent “ordered [the investigator] to change the portion of his report describing the facts of the accident and his analysis of liability ‘wherein [he] had indicated an exposure [for the defendant], and that there could be a high settlement value on it.’” More generally:

First, State Farm repeatedly and deliberately deceived and cheated its customers via the PP & R scheme. For over two decades, State Farm set monthly payment caps and individually rewarded those insurance adjusters who paid less than the market value for claims. Agents changed the contents of files, lied to customers, and committed other dishonest and fraudulent acts in order to meet financial goals. . . . . As the trial court found, State Farm’s fraudulent practices were consistently directed to persons—poor racial or ethnic minorities, women, and elderly individuals—who State Farm believed would be less likely to object or take legal action.

Second, State Farm engaged in deliberate concealment and destruction of all documents related to this profit scheme. State Farm’s own witnesses testified that documents were routinely destroyed so as to avoid their potential disclosure through discovery requests. Such destruction even occurred while this litigation was pending. Additionally, State Farm, as a matter of policy, keeps no corporate records related to lawsuits against it, thus shielding itself from having to disclose information related to the number and scope of bad faith actions in which it has been involved.

Third, State Farm has systematically harassed and intimidated opposing claimants, witnesses, and attorneys. For example, State Farm published an instruction manual for its attorneys mandating them to “ask personal questions” as part of the investigation and examination of claimant in order to deter litigation. . . . .

There was also evidence that State Farm actually

25. Campbell, 65 P.3d at 1141.
instructs its attorneys and claim superintendents to employ "mad dog defense tactics"—using the company's large resources to "wear out" opposing attorneys by prolonging litigation, making meritless objections, claiming false privileges, destroying documents, and abusing the law and motion process.26

There is little reason to suppose that State Farm is the worst offender in the industry, or that other companies are not subject to similar temptations.27 The prevalence of bad faith actions against insurance companies suggests the behavior is substantial.28 Indeed, for these purposes first-party bad faith actions are relevant as well; an insurance company that stonewalls its policyholders is at least as likely to treat claimants against its policyholders the same.29

B. Causes

The phenomenon of insurance company intransigence is hard to explain using the traditional approaches to settlement. In cases in which liability is relatively clear and damages are likely to be very high, the approaches do not predict such opposition to settlement. Traditional approaches predict instead that insurance companies want to avoid the reputational and financial effects of

26. Id. at 1148 (citations omitted).
28. There are entire treatises on insurance bad faith, see, e.g., STEPHEN F. ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES (1997), and an active Bad Faith Insurance Litigation Insurance Group of the American Association of Justice (formerly Association of Trial Lawyers of America), see "AAJ Litigation Groups, http://justice.org/litgroups/index.aspx, last visited June 16, 2008.
29. For examples of large scale programs by first-party insurers to delay or deny claims, see RAY BOURHIS, INSULT TO INJURY: INSURANCE, FRAUD, AND THE BIG BUSINESS OF BAD FAITH (2005); David Berardinelli, An Insurer in the Grip of Greed, 43 TRIAL 7, July 2007, at 32.

As described below, insurance company executives have explained and even celebrated the strategy of denying claims to retain accrued premiums for as long as possible. See infra text and notes 35-41.
very large verdicts, which are very likely to occur. Bad faith law makes it more likely that they will have to pay beyond the policy limits, an excess that could be avoided by early settlement. But the models are inconsistent with the phenomenon of intransigence, so further explanation is required. In fact, because of three factors, intransigence is a rational strategy for insurance companies to pursue. The factors that suggest that intransigence is a rational strategy also provide indirect evidence for the prevalence of the phenomenon; it is reasonable to assume that insurance companies behave in ways that maximize their profitability, and the factors explain why intransigence is profit maximizing.

1. Lower risks. Intransigence is more attractive when the risks of intransigence are lower. The success of tort reform measures and the limits of bad faith law each reduces the risks to an insurance company that unreasonably refuses to settle a case. Consistent with the economic model of settlement, if the expected value of litigation is lower, then the insurance company is subject to less risk if it takes a case to trial.

In many states, statutes that have been enacted under the banner of tort reform limit the victim's potential recovery, such as a cap on noneconomic damages or the statutory or constitutional limits on punitive damages. These measures decrease the expected value of the case and therefore the risk of trial for the company. The greater the limitation on recovery is, the greater the incentive to avoid settlement. In Indiana, for example, a hard cap on total damages in medical malpractice cases removes practically all incentive to settle many large cases; the only added expense of going to trial is the transaction costs, and there have been reports that some insurance companies have even limited these by negotiating low fees with the firms they frequently retain.

In theory, a company has no incentive to gamble with the

32. The reports on Indiana are anecdotal accounts by plaintiffs' lawyers. As a general matter, insurance companies purchase legal services wholesale and are therefore able to negotiate for lower costs. In Kritzer's terms, insurance defense has become a commodity. See Defending Torts, supra note 9, at 32-38; Commodification, supra note 9, at 2088-89.
insured's money by refusing to settle within the policy limits because the law of bad faith will require the company to pay the excess judgment. In many jurisdictions, however, bad faith is not fully effective in deterring the company because of the liability standard applied and the uncertainty of its application. Courts variously use negligence, bad faith, good faith, and interest-balancing rules to evaluate the company's conduct. None of these approaches imposes strict liability for rejecting a settlement offer; each instead requires the court to exercise judgment about the conduct, and there is always a degree of uncertainty about that judgment. In particular, the more complex the underlying case is, (large cases are typically complex), the less clear it will be that the company has acted wrongfully. In a complex medical malpractice case, for example, the facts could be sufficiently complex and the need for judgment by the defendant physician sufficiently nuanced that the company has room to argue about the reasonableness of its failure to settle.

2. Float. Insurance companies have two sources of profit. Underwriting profit results from taking in more money in premiums than is paid out in claims and expenses. Investment profit results from earning income on funds reserved for future claims payouts. Investment profit is determined by two factors: the rate of return on investments and "float"—the delay between collecting premiums and paying claims. Even if an insurance company ultimately has to pay a judgment, there is a financial advantage to delaying the payment and capturing the time value of the money. In recent years companies have paid greater attention to the value of float and therefore have greater incentive to delay or deny payment of large claims.

33. Keeton & Widiss, supra note 17, at 880-84. See also Kenneth Abraham, The Natural History of the Insurer's Liability for Bad Faith, 72 Tex. L. Rev. 1295, 1295 (1994) ("liability for bad faith is no longer quite the dramatic threat to insurers—nor for most plaintiffs the potential pot of gold at the end of the rainbow—that it may once have seemed to be").

34. See generally Emmett Vaughan & Therese Vaughan, Essentials of Risk Management and Insurance ch. 7 (2001).

35. Richard E. Stewart & Barbara D. Stewart, The Loss of the Certainty Effect, 4 Risk Mgmt. & Ins. Rev. 29, 32 (2001). Stewart and Stewart also point out that the recent shift from "orientation toward policyholders to orientation toward stockholders" contributes to the reluctance to pay out large claims. Id. at 31.
Warren Buffett has trumpeted utilizing float as a free source of capital. In his most recent letter to the shareholders of Berkshire Hathaway, the "oracle of Omaha" summed the concept up succinctly: "float is money we hold that is not ours but which we get to invest." 36 "An insurance business has value if its cost of float over time is less than the cost the company would otherwise incur to obtain funds. But the business is a lemon if its cost of float is higher than market rates for money." 37

Berkshire Hathaway is certainly an unusual company because of its preeminence, its size (its principal primary insurer is GEICO, it also owns MedPro, a major medical malpractice insurer, and it has two major reinsurance companies, General Re and B-H Reinsurance), 38 and its management, but it provides a useful example. At the end of 2006, Berkshire had float of $50.6 billion, and Buffett reported that over time, its cost of float was likely to fall to less than zero; 39 that is, its insurance companies had underwriting profits. This has been the case in about half of the years it has been in the insurance business, even though in the aggregate, most insurers operate at an underwriting loss. 40

Float is particularly attractive to companies whose cost of capital is high or who (like Buffett’s Berkshire Hathaway) have a high rate of return on invested capital. It is even more attractive when, as in most jurisdictions, there is either no requirement that the company pay prejudgment interest on tort judgments, or the interest rate is set at rates that more closely reflect short-term interest rates than long-term capital rates. 41

3. Attack on trial lawyers. The strategy of intransigence may involve both a short-term and a long-term attack on trial lawyers.

The short-term attack takes advantage of elements of the bargaining theory of negotiation. Refusing to settle, delaying

37. Id.
41. See infra text and notes 79-84.
settlement, or requiring litigation imposes tremendous costs on trial lawyers. A large medical malpractice case, for example, can frequently require an investment in costs and time of $200,000. 42 Although there may be an expected return that theoretically is commensurate with the cost and risk, as a practical matter most plaintiffs' lawyers cannot manage their case portfolios to sustain an investment in such cases, or certainly in many such cases (and the means of financing the investment are very expensive, too). 43 Because of the expense as well as problems of expertise, the supply of lawyers available to take such cases is relatively inelastic. The result is to limit the supply of lawyers willing to take such cases or pursue them aggressively, so cases are not brought or are settled earlier and for lower amounts than they might be otherwise.

The long-term attack extends the short-term attack. The ability to sustain a firm that pursues large cases requires a portfolio management strategy based on big wins in major cases within a reasonable time and following a reasonable investment. Over time, the true expected value of large cases declines. The effect is to reduce the willingness and ability of lawyers to take such cases, and eventually to drive lawyers out of this area of practice.

There is an analogy here to other tort reform strategies. Insurance companies and other corporate interests have invested huge amounts in lobbying, public relations, and litigation around issues such as demonizing trial lawyers, enacting damage caps, and limiting punitive damages. 44 All of these activities impose short-term costs on the companies for which they receive no immediate benefit. In the long run, however, the strategies have been enormously effective in not only achieving specific reforms

42. See Anthony J. Sebok, Dispatches from the Tort Wars (Review Essay), 85 Tex. L. Rev. 1465, 1490-95 (2007) (noting the expenses involved in a large torts case and arguing that plaintiffs' lawyers being paid on a contingency basis generally have incentive to screen cases based on merit, since they bear the costs if the plaintiff does not receive a favorable settlement); David A. Hyman & Charles Silver, Medical Malpractice Litigation and Tort Reform: It's the Incentives Stupid, 59 Vand. L. Rev. 1085, 1117-20 (2006) (same).

43. On plaintiffs lawyers as portfolio managers, see Herbert M. Kritzer, Risk, Reputations, and Rewards: Contingency Fee Legal Practice in the United States 12-19 (2004).

44. See generally Feinman, supra note 30.
but in changing the economics of law practice for victims' lawyers.\textsuperscript{45} The most extreme example arises in jurisdictions such as Texas in which the medical malpractice bar has been decimated by severe reforms.\textsuperscript{46} The same phenomenon may be at work here: short-term costs (in added litigation expenses and perhaps even judgments) for long-term benefits.

C. Consequences

The phenomenon of insurance company intransigence distorts normal settlement processes and undermines the objectives of the tort system. While insurance companies are strategically intransigent, tort victims need funds to replace lost income and for medical and other expenses, they are risk averse, and their lawyers are subject to the uncertain economics of contingency fee practice. Therefore, some cases settle for far below the expected value of the case. Other cases go to judgment, and for many of those there is under-compensation if, due to the limits of bad faith law, the insurance company is not required to pay the excess above the policy limit and is not liable for additional costs of delay such as additional litigation costs. To the extent that there is under-compensation, there is also inadequate deterrence. The assumption of the system is that insurance costs are a rough proxy for real costs, so the cost of insurance encourages a proper degree of care. That does not happen if insurance costs are reduced by intransigence. Fairness is to a large extent a function of compensation and deterrence, so the system is less fair as well to the extent that those objectives are underserved. In the long term, to the extent that intransigence continues, tort objectives will be increasingly undermined because of the damage done to the victims' bar.\textsuperscript{47}

\textsuperscript{45} See id. at 12-19.

\textsuperscript{46} TEX. CIV. PRAC. & REM. CODE ANN. §§ 74.301, 74.401 (Vernon 2005). \textit{See also} Daniel Costello, Lacking Lawyers, Justice Is Denied, L.A. TIMES, Dec. 29, 2007 (decline of medical malpractice cases following enactment of damage cap).

\textsuperscript{47} Outside the tort system, insurance company intransigence has other deleterious consequences. Insurance is not simply a private contract but also plays an important public role. That role is undermined by intransigence. There is a history in the insurance industry of insurer conduct that undermines confidence in the insurance market and the system of insurance; failure to pay clear claims promptly is another example of that phenomenon.
III. ATTACKING INSURANCE COMPANY INTRANSIGENCE: GENUINE TORT REFORM

Insurance company intransigence is a likely candidate for genuine tort reform, the subject of this Symposium, because it threatens the vitality of the tort system. The objective of reform is to increase the likelihood that large cases in which the liability rules of tort law are violated are resolved in favor of the victim, either by litigation or settlement, with damages that more fully compensate the victim and therefore appropriately fix the cost of wrongdoing. Because these are cases in which the defendant is insured and the insurance company controls the litigation, the insurance company has to act fairly in deciding to settle or litigate or bear the cost of failing to do so. The response also has to recognize the institutional factors at work, particularly the insurance company's status as a repeat player with long-term, strategic interests, the victim's need for timely and adequate compensation, and the victim's lawyer's role as the funder of litigation.

The following sections describe a variety of measures that respond to the problem of insurance company intransigence. Some of these are in place, in whole or part, in a few jurisdictions, but none have been widely adopted. Some would be best implemented through legislation; others could be adopted by the courts through extensions, modest or ambitious, of existing doctrine.

A common feature of all of the proposals is that they are focused on the particular issue of advancing the objectives of the tort system by imposing liability for insurance company intransigence. Law works through doctrine. Doctrine is often general, but it is always applied, as here, in context. The institution of insurance is generally understood to provide a distinctive context for the application of general doctrines; issues of contract interpretation or misrepresentation, for example, take on a particular flavor when the insurance relationship is involved. Insurance plays key roles in the tort system and it is accordingly and, in the long run, erodes the role of insurance in society. For example, incontestability clauses arose to remedy opportunistic behavior by insurance companies that eroded public confidence in insurance. See Galanty v. Paul Revere Life Ins. Co., 1 P.3d 658 (Cal. 2000).
imbued with a public interest. Some of the doctrines discussed here, such as insurance company bad faith, focus specifically on the insurance context. Other doctrines, such as intentional infliction of emotional distress and wrongful litigation, are very general. With respect to those doctrines, the expansion suggested here is modest precisely because it is focused on the particular problem of insurance company intransigence.

A. The Good Faith Duty Owed to the Insured

A starting point for analysis is the insurance company's duty of good faith to its insured. This duty provides a baseline for evaluating the insurance company's behavior, but it is not adequate to address the problem of intransigence.

Liability insurance policies routinely empower the insurer to settle claims against the insured, and the courts require that this power be exercised with appropriate regard for the insured's interest—that is, in good faith. In cases in which the insurance company commits bad faith and the failure to settle results in a judgment in excess of the policy limits, the company is required to pay the excess judgment. The law of bad faith is complex, involving, across the jurisdictions, different standards and different factors that the courts look to in applying those standards. The variation and vagueness of many standards often makes it difficult to establish bad faith because the company can point to some vagueness or uncertainty in the facts of the case. In part for this reason, commentators have considered whether companies should be strictly liable for excess judgments in cases in which they rejected settlement offers. Two courts

48. See Robert H. Jerry, Understanding Insurance Law 897 (2002); Keeton & Widiss, supra note 17.
49. Jerry, supra note 48, at 898-908; Keeton & Widiss, supra note 17, at 897.
50. Keeton & Widiss, supra note 17, at 880-87.
51. More than a decade ago, Kenneth Abraham concluded that "liability for bad faith is no longer quite the dramatic threat to insurers—nor for most plaintiffs the potential pot of gold at the end of the rainbow—that it may once have seemed to be" and "the probability of substantial doctrinal expansion in this field is low." Kenneth Abraham, The Natural History of the Insurer's Liability for Bad Faith, 72 Tex. L. Rev. 1295, 1295 (1994).
52. See Jerry, supra note 48, at 901-03; Keeton & Widiss, supra note 17, at 886-89.
have approached strict liability, but there does not seem to be a trend in that direction.

The duty to settle in good faith benefits the victim in that it provides funds to satisfy the judgment that otherwise would not be available, because the defendant might not be pursued for the excess or because the defendant is judgment proof. In many cases the insured defendant assigns its bad faith claim to the victim, in exchange for the victim agreeing not to pursue the defendant for any amount above the policy limits. But assignment is not adequate to redress the victim's injury caused by company intransigence, because the victim's action against the company must await the conclusion of the litigation and, more importantly, is a limited right. Even under a strengthened bad faith standard, because the victim takes the right by assignment, the victim stands in the shoes of the insured and is entitled to recover only for the insured's losses, and sometimes not even to that extent; some jurisdictions limit the victim's recovery to the amount of the excess, excluding other damages suffered by the insured such as emotional distress. This does not solve the problems of delay, under-compensation, and under-deterrence.

B. Unfair Claims Settlement Practices Acts

The National Association of Insurance Commissioners has adopted a Model Unfair Claims Settlement Practices Act, some version of which has been enacted in nearly every jurisdiction.


54. JERRY, supra note 48, at 902-03; KEETON & WIDISS, supra note 17, at 887.

55. 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).


57. See generally Steven Plitt & Christie L. Kriegsfield, The Punitive Damages Lottery Chase Is Over: Is There a Regulatory Alternative to the Tort
The acts include a long list of actions prohibited to insurance companies in resolving claims. Particularly relevant are provisions that state it is a violation for a company to:

- fail to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;\(^{58}\)
- not attempt in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear;\(^{59}\)
- compel insureds or beneficiaries to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them;\(^{60}\)
- make known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration.\(^{61}\)

In addition to specific variations in the language of enacted statutes, there are two general variations. The first variation turns on whether a single act constitutes a violation. The great majority of statutes include the requirement that prohibited acts constitute a violation if committed "with such frequency as to indicate a general business practice" or similar language.\(^{62}\) The other statutes find a single act to be a violation.\(^{63}\)

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\(^{58}\) MODEL UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 4C (2007).

\(^{59}\) Id. § 4E.

\(^{60}\) Id. § 4D.

\(^{61}\) This provision is not included in the Model Act but is included in many state enactments. E.g., N.J. STAT. ANN. § 17:29B-4(9)(k) (West 2001).


\(^{63}\) Plitt & Kriegsfield, supra note 57, at 1249-50.
In dealing with the problem of insurance company intransigence, each type of provision has its advantages. If only a single act is required, the proof is simpler in that the violation in a particular case is sufficient. But under the business practice rule, discovery should be available to victims’ lawyers to establish whether the violation shown in the individual case is unique or is part of a general business practice. From a policy perspective, that gives broader range to the possibility of discovering and remedying abuse. From the victim’s perspective, the company’s likely desire to avoid discovery on that issue creates greater pressure for the company to settle the case.

The second variation concerns whether the statutes covers “insureds” (for present purposes, defendants in tort litigation) or “insureds and claimants” (defendants and victims). If a court were to imply a private right of action based on the statute, whether plaintiffs were within the scope of the statutory language would be significant. In fact, relatively few jurisdictions allow anyone, insured or victim, to bring a private claim under the statute.64 Most jurisdictions require the insured to pursue administrative remedies.65 Only a few statutes specifically allow an action by the victim,66 and only a few more jurisdictions reach the same result by judicial implication of a private right of actions.67

Even though jurisdictions generally do not allow private actions, they do provide for administrative enforcement through a system of penalties by the insurance commissioner or other official. Under the Model Act and many statutes, there is a two-tiered system of penalties, with higher penalties for knowing violations, and, remarkably, a cap on aggregate penalties within a specified period.68 Some of the penalties are modest. Connecticut, for example, has a penalty of $1,000 per violation and $10,000 in the aggregate per six-month period for tier one and $5,000

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64. Id. at 1268-84.
65. Id. at 1269.
per/$50,000 aggregate for tier two violations. Others are more dramatic.; Illinois has a penalty up to $250,000 for a single violation with no aggregate cap. In addition to monetary penalties, the statutes provide the theoretical possibility of revocation on a company's permission to do business in a state, although such a sanction is hard to imagine.

There is seldom adequate reporting of enforcement proceedings, so it is hard to know if these measures are effective. Looking at what reports are available, it seems sanctions tend toward the modest side. This is likely not because the companies do not engage in such behavior, but because insureds, victims, and their lawyers typically do not report such behavior and the regulators do not aggressively enforce the statutes.

72. Some states require companies to maintain records of complaints. See, e.g., Vt. Stat. Ann. tit. 8, § 4724(10) (2007). Other states require that the complaints be reported and available for use in litigation. See, e.g., N.H. Rev. Stat. Ann. § 417:4-XV(b) (2004). Evidence as to numbers and types of complaints to the insurance department against an insurer, and said department's complaint experience with other insurers writing similar lines of insurance, shall be admissible in evidence in an administrative or judicial proceeding brought under this title, provided that no insurer shall be deemed in violation of this section solely by reason of the numbers and types of such complaints.
The most important reform concerning these statutes would be to provide a private right of action to the tort victim who is injured by unfair claims settlement practices. That cause of action would serve the statutory purpose by providing a remedy for the one who is actually harmed by the practices—in cases of intransigence, the plaintiff-victim, not the defendant-insured—and by providing a substantial disincentive for companies to engage in the practices. The remedy would be the damages suffered by the plaintiff, which would include not only the excess judgment over the policy limit but also consequential economic losses, damages for emotional distress, and attorneys fees and the other costs of establishing the claim.

If enforcement of the statutes remains primarily regulatory, those statutes that provide only modest sanctions should be strengthened with realistic penalties. More important is the need to enforce statutes already on the books. No new law is required for victims’ attorneys to report routinely insurance bad faith and to press regulators to enforce more aggressively the statutes. Anecdotal evidence supports that the possibility of reporting provides considerable leverage to victims in settlement negotiations. On the regulators’ side, as a historical matter insurance commissioners generally have been more passive in regulating than have attorneys general. The model of Eliot Spitzer—an attorney general who is both interested in remedying bad insurance behavior and other injuries to consumers and who is politically ambitious—may inspire other regulators and increase the stakes for insurance companies.

C. A Common Law Action for Bad Faith to the Victim

In the absence of statutory reform, the courts could create a common law cause of action, enforceable by the victim, for insurance company bad faith refusal to settle. As the courts


75. The leading article is Francis J. Mootz III, The Sounds of Silence: Waiting for Courts To Acknowledge that Public Policy Justifies Awarding Damages to Third-Party Claimants when Liability Insurers Deal with Them
often recognize, insurance is a dependent relationship, heavily regulated, and imbued with the public interest. Beyond the parties to the insurance contract, the insurance system provides for the redistribution of funds from pooled premiums to injured persons. This is especially true for situations of mandatory insurance, such as auto insurance, but it is true of all liability coverage. The public has an interest in fair and efficient settlement. Because of regulatory inadequacies, there is no means of effectuating this interest other than through a private right of action.

The standard for bad faith needs to be fleshed out in the cases. Some suggestions from the literature and cases:

"use of specious and pretextual arguments to avoid settlement" 76

"use of delay in payment to exert pressure to get a third party to accept less than it could reasonably expect" 77

failure to settle "when the insured's liability is reasonably clear and the claimants' damages are reasonably ascertainable and which they have contracted to cover." 78

The damages in this action would flow from its nature as a tort action: all loss proximately caused by the wrongful conduct. In a case in which the victim was required to settle early and for less than the full damages, part of the recovery is the difference between the amount that was received in settlement and the full damages that the case was worth. In every case, the loss includes the attorneys fees and other costs due to the bad faith, emotional distress damages, and, in a proper case (of which there may be many), punitive damages.


76. Mootz, supra note 75, at 485.
77. Id.
78. Krupnick, 34 Cal. Rptr. 2d at 65.
The insurance company that is required to pay a judgment is, in most jurisdictions, subject to the disincentive for delay of being required to pay prejudgment interest in addition to the amount of the judgment itself. Traditionally prejudgment interest was not awarded on unliquidated claims, such as tort claims, the amount of which could not be computed before trial. The rationale was protective of defendants; the defendant could not reasonably be expected to satisfy an obligation the amount of which was uncertain and in dispute.  

Over time courts and legislatures recognized that failing to award prejudgment interest constitutes a loss to the plaintiff and a benefit to the defendant, as the defendant has the use of the plaintiff's funds interest-free until the time of payment. In response, jurisdictions have either vested discretion in court or jury to award prejudgment interest or established the award of interest as a matter of right. In most jurisdictions, therefore, the extent to which prejudgment interest provides a disincentive for insurance company intransigence is not the allowance of prejudgment interest, but the rate at which it is assessed. The rates vary among the jurisdictions, but a significant effort by the American Tort Reform Association (ATRA) to limit the effect of prejudgment interest has resulted in relatively low rates of interest. ATRA proposed that the interest rate be set at the U.S. Treasury bill rate at the time the action was filed, and many jurisdictions have responded by setting the rate at approximately that rate.

The availability of prejudgment interest at rates that approximate short-term funds rates does not provide much of a

disincentive to intransigence. The relevant time period is between the time of offer and the time of conclusion of litigation, which, given the delays common in litigation, is likely to be several years rather than several months. Indeed, even when an individual case is concluded within a relatively short time period, because the insurance company maintains a continuing portfolio of cases, the funds not paid out to tort victims—the float—is really a long-term source of capital for the company. Making prejudgment interest mandatory and increasing the interest rate substantially would provide more of a disincentive. A few states have a rate on tort claims as high as 12%, but there is no empirical evidence that even that rate deters intransigence.

A related potential reform is expanding offer of judgment rules. The most common rule, in effect in the federal system and more than half the states, has two defects. That rule is a one-way rule; a defendant but not a plaintiff may make an offer of judgment with adverse consequences for the other party who fails to do appreciably better in court. The adverse consequences are modest; the party is responsible for court costs but not attorneys fees or other costs of the party extending the offer.

A number of states link offer of judgment and prejudgment interest by altering the prejudgment interest rate on offers that are rejected to the disadvantage of an offeree who obtains a less favorable judgment. A few states, such as Alaska and New Jersey, have bilateral offer of judgment rules. In theory these rules should be effective in reducing intransigence because it

83. In Coleman v. Gulf Insurance Group, 718 P.2d 77 (Cal. 1986), the plaintiffs asserted that by filing a frivolous appeal, the defendant's insurance company could “capitalize during the pendency of the appeal on the significant differential between the statutory rate of interest (7%) and the general market rate (15%).” Id. at 79.
84. E.g., MASS. GEN. LAWS ch. 231, § 6B (1958); VT. STAT. ANN. tit. 9, § 41a (1959).
86. Solimine & Pacheco, supra note 85, at 64.
87. Id.
89. See McCarthy, supra note 88.
increases the cost of that strategy; a company that refuses a reasonable settlement offer increases the expected value of its ultimate loss, because it will be liable for the victim's excess attorney fees due to its unreasonableness.  

The empirical evidence is mixed, however. A study of the Alaska rule reported mixed effects of the rule in a minority of cases, and then more often in contract than tort cases, putting pressure on defendants in substantial cases in which liability was clear, but the effect was greatest on parties of moderate means; the study did not account for insurance companies as major actors. A study of New Jersey's rule found the rule had little effect on the size of damage awards but did reduce the duration of litigation and therefore attorney fees. Further experimentation with substantial offer of judgment rules may be worthwhile to ascertain their effect in punishing intransigence.

E. Intentional Infliction of Emotional Distress

An insurance company's refusal to settle a case in which liability is clear and damages are large and certain is egregious behavior. Accompanied by special circumstances such as an injured, destitute victim in immediate need of funds or extreme behavior such as using the discovery process to embarrass and oppress as in State Farm Mutual Automobile Insurance Co. v. Campbell is outrageous. In that sense, there is a well-established tort directed at that type of conduct: the tort of outrage, or intentional infliction of emotional distress.

Although the rule at common law through the early twentieth century barred recovery for emotional harm in the absence of

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90. Attorneys take all these cases on a contingency fee basis, but attorneys fees can be calculated by various methods as they are in other cases in which attorneys fees are statutorily provided for, such as consumer fraud or civil rights cases.


physical injury, courts recognized exceptions for particularly egregious acts, such as practical jokes gone bad or extraordinary meanness, and, more importantly, for entities such as common carriers, innkeepers, and telegraph companies that had a heightened responsibility toward their customers. The first Restatement of Torts, published in 1934, did not recognize the tort, but the Supplement published in 1948 added the tort for "unprivileged" conduct. Today intentional infliction of emotional distress is widely adopted by courts, often using the formulation of the Restatement Second of Torts:

§ 46. Outrageous Conduct Causing Severe Emotional Distress

(1) One who by extreme and outrageous conduct intentionally or recklessly causes severe emotional distress to another is subject to liability for such emotional distress, and if bodily harm to the other results from it, for such bodily harm.

The elements of the tort therefore include:

(1) The defendant acts intentionally or recklessly;

(2) The defendant's conduct is extreme and outrageous;

(3) The defendant's conduct is the cause of the plaintiff's emotional distress;

(4) The plaintiff's emotional distress is severe.

These elements can be analyzed separately. For example, the first element can be satisfied where the defendant intends to inflict severe emotional distress, is certain that severe emotional distress will result from its conduct, is substantially certain that severe emotional distress will result from it, for such bodily harm.

96. RESTATEMENT OF TORTS § 46 (1934).
97. RESTATEMENT OF TORTS § 46 (Supp. 1948).
98. RESTATEMENT (SECOND) OF TORTS § 46 (1965).
high degree of probably that emotional distress will follow from its conduct (recklessness). 99

To a considerable extent, however, the tort focuses on the singular element of outrageousness. 100 Intention to cause distress through conduct that is not outrageous is not actionable, while outrageous conduct presumes intention or recklessness. 101 Outrageousness also validates the severity of the emotional distress suffered by the plaintiff. Thus, the key question for insurance cases is what type of conduct by an insurance company is sufficiently outrageous to be actionable.

The Restatement and the case law suggest the limitations and the possibilities of application of the tort to the insurance context. The Restatement's general position, 102 mirrored by the courts, is narrow.

Liability has been found only where the conduct has been so outrageous in character, and so extreme in degree, as to go beyond all possible bounds of decency, and to be regarded as atrocious, and utterly intolerable in a civilized community. Generally, the case is one in which the recitation of the facts to an average member of the community would arouse his resentment against the actor, and lead him to exclaim, "Outrageous!" 103

And as applied to disputes about tort litigation, there is a further problem:

The conduct, although it would otherwise be extreme and outrageous, may be privileged under the circumstances. The actor is never liable, for example, where he has done

99. Id. § 46, cmt. i.
100. See Givelber, supra note 95, at 46-51.
101. DOBBS, supra note 94, at 826; Givelber, supra note 95, at 46-47.
102. When the Restatement was published in 1965 its authors included a qualification about the development of the law:

The law is still in a stage of development, and the ultimate limits of this tort are not yet determined. This Section states the extent of the liability thus far accepted generally by the courts. The Caveat is intended to leave fully open the possibility of further development of the law, and the recognition of other situations in which liability may be imposed.

RESTATEMENT (SECOND) OF TORTS § 46, cmt. c (1965).

The case law since then has been substantial, but in significant respects it still reflects the Restatement view.
103. RESTATEMENT (SECOND) OF TORTS § 46 cmt. d.
no more than to insist upon his legal rights in a permissible way, even though he is well aware that such insistence is certain to cause emotional distress.\textsuperscript{104}

On the other hand, the Restatement recognizes the significance of the defendant’s actual or potential power or authority over the victim:

The extreme and outrageous character of the conduct may arise from an abuse by the actor of a position, or a relation with the other, which gives him actual or apparent authority over the other, or power to affect his interests.\textsuperscript{105}

The illustrations to this point include a private detective posing as a police officer,\textsuperscript{106} a school principal exercising authority over a student,\textsuperscript{107} and the classical case of a creditor abusing a debtor.\textsuperscript{108}

Intentional infliction has often been alleged in insurance cases as an alternative or additional remedy to violation of an unfair claims settlement practices act or a common law bad faith action.\textsuperscript{109} In fact, the tort played a significant role in the early development of the bad faith action. In \textit{Fletcher v. Western National Life Insurance Co.},\textsuperscript{110} the California court upheld an emotional distress claim against a disability insurer, allowing recovery including punitive damages for a tort action arising out of the contractual relationship between insurer and insured.\textsuperscript{111} The company ignored the consensus of medical reports concerning the insured’s disability, fabricated an allegation of misrepresentation against the insured, ceased payments that it knew to be due, and attempted to coerce the insured into a settlement by taking advantage of his precarious financial condition.\textsuperscript{112} Ultimately the company conceded that its conduct

\textsuperscript{104} Id. \textsuperscript{105} Id. \textsuperscript{106} Id. \textsuperscript{107} Id. \textsuperscript{108} Id. \textsuperscript{109} See Gregory G. Sarno, \textit{Liability of Insurer, or Insurance Agent or Adjuster, for Infliction of Emotional Distress}, 6 A.L.R.5th 297 (1992). \textsuperscript{110} 89 Cal. Rptr. 78 (Dist. Ct. App. 1970). \textsuperscript{111} Id. at 93. \textsuperscript{112} Id. at 83-87.
had been outrageous but argued that the evidence of its behavior was privileged as communication between adverse contracting parties attempting to settle a dispute. The court recognized that privilege was possible but held it did not extend to the assertion of rights in an outrageous manner.

In recognizing the availability of the action for outrage, the Fletcher court focused on the relationship between the parties which, though contractual in origin, could give rise to tort duties:

In determining whether liability should be imposed for intentional infliction of emotional distress, the cases and commentators have emphasized the significance of the relationship between the parties in determining whether liability should be imposed. Additionally, the special obligation of public utilities and other enterprises affected with the public interest has been noted as significant in the imposition of liability upon such defendants even in the absence of outrageous conduct, apparently upon a policy basis of encouraging fair treatment of the public whom the enterprises serve. Both of these considerations are pertinent to the case at bench. The insurance business is governmentally regulated to a substantial degree. It is affected with a public interest and offers services of a quasi-public nature. An insurer has a special relationship to its insured and has special implied-in-law duties toward the insured. To some extent this special relationship and these special duties take cognizance of the great disparity in the economic situations and bargaining abilities of the insurer and the insured.

The emphasis on the special relationship between insurer and insured means that the great majority of cases are first-party insurance cases, and even then often not successful. Liability insurance cases are rare because the insurance company and the plaintiff are adverse parties, and courts generally conclude that the absence of the kind of protective relationship evident in first-party cases or the older common carrier cases makes outrage harder to come by. Cluff v. Farmers Insurance Exchange,

113. Id. at 89.
114. Id. at 89-90; see also Doctor’s Co. Ins. Servs. v. Superior Court, 275 Cal. Rptr. 674 (Dist. Ct. App. 1991).
115. Fletcher, 89 Cal. Rptr. at 95.
decided contemporaneously with *Fletcher*, is instructive.\textsuperscript{117} After the death of her minor son, Cluff was "threatened and cajoled" by the tortfeasor's insurance company to accept a settlement, telling her that if she hired an attorney she would recover nothing.\textsuperscript{118} Despite the threats she hired an attorney who advised the company to cease all contact with Cluff except through the attorney.\textsuperscript{119} Nevertheless, the company's representative continued to contact her, telling her "he hated the fact" that she had hired a lawyer, that her lawyer would not win the case, that the most she would get was what the company was offering whereas she might get nothing at all by taking the matter into court; and that if she changed her mind about being represented by counsel to have the attorney send them a letter to that effect after which the insurance company would get the money to her "because she probably needed it."\textsuperscript{120}

Arizona had adopted the tort of intentional infliction of emotional distress, using Restatement Second §46, but the tort did not extend to the facts in this case.\textsuperscript{121} The court distinguished cases like this one, in which the insurance adjuster contacted the plaintiff, even knowing that she was represented by counsel, in a possibly aggressive attempt to settle the case, from those in which the adjuster committed further "aggravated acts." It pointed to the contrast between the facts there and those in *Interstate Life & Accident Co. v. Brewer*,\textsuperscript{122} for example, (a first-party case, incidentally), in which the insurance adjuster contacted the plaintiff while she was in bed recovering from a heart attack, advised her that his company was cutting her payments, threw a handful of coins in her face, and yelled at her "You don't need a doctor, you ought to die!"\textsuperscript{123} In the absence of such aggravated conduct, no cause of action would lie, because "[t]he course of human conduct even in our 'civilized' community has amply shown that self seeking and inconsideration are a common trait in man's relationship with man. The law does not purport to protect

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\textsuperscript{117} Id.
\textsuperscript{118} Id. at 667-68.
\textsuperscript{119} Id. at 667.
\textsuperscript{120} Id. at 668.
\textsuperscript{121} Id. at 668-69.
\textsuperscript{122} 193 S.E. 458 (Ga. Ct. App. 1937).
\textsuperscript{123} Id. at 459-60.
individuals from the minor manifestations of this human conduct."124

Cluff illustrates the difficulties in applying the tort of outrage to insurance company intransigence, and Fletcher its possibilities. Courts that require specific acts of aggravated conduct will not find the action available to the general problem of intransigence. Even in those jurisdictions, it should still apply in many cases because the intransigence is often accompanied by particular acts such as threats or oppressive discovery. The more general problem is the extent to which the action is available in third-party cases. Fletcher and many other cases recognize the uniqueness of the insurance context, but focus on the protective role of insurer toward insured.125

Outrage is, like negligence, an open-ended tort, applying a general standard to an infinite variety of particular situations. Like negligence, it is made more determinate as it is repeatedly applied in similar contexts. Some of the outrage cases are singular, particular in the early days of the tort's development, such as the unfunny practical jokes.126 But increasingly the tort has been applied in a few relational contexts, such as employer-employee, creditor-debtor, and insurer-insured.127 As Givelber notes, these cases "essentially require a minimum fair procedure in dealings between people who occupy unequal bargaining positions and are bound (or apparently bound) by voluntary agreements."128 As courts and legislatures increasingly have recognized that liability insurance companies owe duties to the victims of their insureds' actions, the tort can be used to establish "minimum fair procedure" in that context as well.

F. Wrongful Litigation

Conventionally there are two torts for wrongfully using civil litigation: (1) malicious prosecution or use of process,129 and (2)

124. Cluff, 460 P.2d at 669.
125. See Fletcher, 89 Cal. Rptr. 78.
127. Givelber, supra note 95, at 62-69; Sarno, supra note 109.
128. Givelber, supra note 95, at 68.
abuse of process. Although these torts have seldom been applied to defensive action, they represent a particularly fruitful source of doctrinal development in remediying insurance company intransigence.

The defendants in the wrongful litigation action can be either or both of the insurance company and the counsel it retains on behalf of its insured. The attorney who misuses the civil litigation process is obviously liable. The insurance company that directs the attorney to do so also is liable. As a practical matter, in most cases, the attorney does not exercise wholly independent judgment about the conduct of the litigation; instead, the company sets the parameters for defense and authorizes or fails to authorize settlement negotiations. Although the defendant insured is the nominal party, because it typically has no control over the litigation, it should not be liable for malicious defense.

Malicious civil prosecution is traditionally directed at wrongfully initiating or continuing an action. The elements of the cause of action are:

1. The original action complained of was brought without probable cause;
2. It was actuated by malice;
3. It was terminated favorably to plaintiff;
4. The plaintiff suffered special injury.

Abuse of process is traditionally directed at misusing some

130. Id. § 682.
131. Id. § 674.
132. Id. § 674 cmt. d.
133. Id. § 674 cmt. b.
134. Defending Torts, supra note 9, at 20-21.
135. See Givens v. Mulliken, 75 S.W.3d 383, 395-96 (Tenn. 2002) (company liable when it “directed, commanded, or knowingly authorized” attorney’s actions.)
137. Dobbs, supra note 94, at 1228-29; Restatement (Second) of Torts § 674.
legal procedure for a purpose for which it was not intended.\textsuperscript{138} The elements of the tort are:

(1) The defendant had a purpose to use civil or criminal process in way for which it was not designed (i.e., maliciously); and

(2) There was actual improper use of process.\textsuperscript{139}

Abuse of process traditionally served to provide a remedy where the requirements of malicious prosecution are not met.\textsuperscript{140} As can be seen from the statements of the elements, they share a core principle of imposing liability for improper use of the legal process. The law is variable across the jurisdictions and in flux,\textsuperscript{141} but as the core has become emphasized and the particular requirements deemphasized, some courts have merged the two into a single tort of using litigation for an improper purpose—that is, for a purpose other than the resolution of disputes and the establishment of legal rights.\textsuperscript{142} With a few exceptions, courts have not recognized a cause of action for defensive action, either in general under malicious prosecution or for abuse of process by particular defensive tactics.\textsuperscript{143} Applying the wrongful litigation torts to defensive action by insurance companies can involve either developing each of the torts separately, or applying the merged tort of improper use of civil litigation; this section considers each in turn.\textsuperscript{144}

\textsuperscript{138} DOBBS, supra note 94, at 1234; RESTATEMENT (SECOND) OF TORTS § 682.
\textsuperscript{139} RESTATEMENT (SECOND) OF TORTS § 682 cmt. a.
\textsuperscript{140} DOBBS, supra note 94, at 1235.
\textsuperscript{141} Id. at 1236.
\textsuperscript{142} The leading case is DeVaney v. Thriftway Marketing Corp., 953 P.2d 277 (N.M. 1997).
\textsuperscript{144} South Dakota has a singular statute that defines barratry as "the assertion of a frivolous or malicious claim or defense or the filing of any document with malice or in bad faith," but it has not been used in this context. S.D. CODIFIED LAWS § 20-9-6.1 (2007).
\textsuperscript{144} For the defense lawyers' critique of applying the wrongful litigation torts to insurance company behavior, see William T. Barker et al., \textit{Litigating about Litigation: Can Insurers Be Liable for Too Vigorously Defending Their
1. Wrongful defense. The basis for a tort of wrongful defense is that the harm of delaying litigation, engaging in excessive discovery, multiplying the victim's costs, and otherwise employing strategies unrelated to the fair resolution of disputes impose as much harm on the victim as bringing a wrongful suit does on the defendant in a classic malicious use of process case.145 The reasons for applying the tort sparingly are sound, but they are inapplicable to the situation of tort litigation, where a repeat player faces a one-shotter and the repeat player has much incentive to engage in wrongful litigation. State Farm Mutual Automobile Insurance Co. v. Campbell,146 summarized earlier, is an example of a clear case of liability with substantial damages brought to trial in the absence of reasonable decisions about the individual case in furtherance of a general plan for improper case management.147

The New Hampshire Supreme Court, in adopting the tort of malicious defense, outlined elements of the cause of action in a way that parallels those for malicious prosecution:

One who takes an active part in the initiation, continuation, or procurement of the defense of a civil proceeding is subject to liability for all harm proximately caused, including reasonable attorneys' fees, if

(a) he or she acts without probable cause, i.e., without any credible basis in fact and such action is not warranted by existing law or established equitable principles or a good faith argument for the extension, modification, or reversal of existing law,

(b) with knowledge or notice of the lack of merit in such actions,

(c) primarily for a purpose other than that of securing the proper adjudication of the claim and defense thereto, such

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146. 538 U.S. 408 (2003).
147. Id.
as to harass, annoy or injure, or to cause unnecessary delay or needless increase in the cost of litigation,

(d) the previous proceedings are terminated in favor of the party bringing the malicious defense action, and

(e) injury or damage is sustained.\textsuperscript{148}

The first element of the tort of malicious prosecution is that the original action complained of was brought without probable cause. In an action based on malicious defense, the first obstacle is that the action was not initiated by the defendant. Although there are not a large number of cases addressing the issue, this has been the principal obstacle to an action for malicious defense. As the California Supreme Court opined in \textit{Eastin v. Bank of Stockton},\textsuperscript{149}

The plaintiff sets the law in motion; if he does so groundlessly and maliciously, he is the cause of the defendant's damage. But the defendant stands only on his legal rights—the plaintiff having taken his case to court, the defendant has the privilege of calling upon him to prove it to the satisfaction of the judge or jury, and he is guilty of no wrong in exercising this privilege.\textsuperscript{150}

Because the other elements of the cause of action can be applied with little alteration from the case of malicious prosecution to the case of malicious defense, this is the crux of the issue. The harm that a plaintiff suffers from malicious defense can be attributed as much to its own conduct in initiating the litigation as to any wrongful action of the defendant. Unlike the defendant who has been wrongfully haled into court by a malicious plaintiff, the plaintiff is to blame for its own situation.

This position is incorrect. The harm suffered by the plaintiff is similar to the harm suffered by the defendant. As the court noted in \textit{Aranson}:\textsuperscript{151}

\textsuperscript{148} \textit{Aranson}, 671 A.2d at 1028-29 (citing Jonathan K. Van Patten & Robert E. Willard, \textit{The Limits of Advocacy: A Proposal for the Tort of Malicious Defense in Civil Litigation}, 35 Hastings L.J. 891, 933-34 (1984)). The injury requirement was not intended to require "special injury."

\textsuperscript{149} 4 P. 1106 (Cal. 1884).

\textsuperscript{150} \textit{Id.} at 1109-10. \textit{See also} Ritter v. Ritter, 46 N.E.2d 41, 44 (Ill. 1943); Alan R. Gilbert, Annotation, \textit{May Action for Malicious Prosecution Be Predicated on Defense or Counterclaim in Civil Suit}, 65 A.L.R.3d 901 (1975).

\textsuperscript{151} 671 A.2d 1023.
Anyone who has been a litigant knows that the fact of litigation has a profound effect upon the quality of one's life that goes far beyond the mere entitlement to counsel fees. Litigation is a disturbing influence to one degree or another. The litigant may have the benefit of skilled and conscientious counsel as well as a strong and well-founded case on the facts, but until such time as the favorable verdict is in hand beyond the reach of appeal, there is a day-to-day uncertainty of the outcome. One wonders about the availability of witnesses at the appropriate times and whether their information will be adequately imparted. One may have gnawing uncertainty about the myriad things that can go wrong in a lawsuit. Here, although the plaintiffs prevailed in their lawsuit, they did so at a price—in time, money, and uncertainty.\footnote{Id. at 1028.}

In this class of cases it is only true in a formal, perhaps formalistic, sense to say that the plaintiff initiated the litigation. Once again, the context is crucial. It is not necessary to argue that a tort of malicious defense should be available in every case to conclude that it ought to be available as a response to insurance company intransigence. The insurance company as a repeat player faces a one-shotter plaintiff whose only means of recovering in a case in which liability and damages are reasonably clear is to initiate litigation. It is meaningful to conclude that the insurance company's stonewalling, not the plaintiff's assertion of its rightful claim, is the cause of the litigation. Moreover, the sole issue is not the commencement of the litigation but its conduct; when the insurance company protracts the litigation without probable cause and for an improper purpose, it unfairly visits harm on the plaintiff and perverts the objectives of the system. In this way, the malicious defense action overlaps the action for abuse of process discussed below.

The action must be defended without probable cause, which the Restatement (Second) of Torts states occurs when one:

[Reasonably believes in the existence of the facts upon which the claim is based, and either

\footnote{Id. at 1028.}
(a) correctly or reasonably believes that under those facts the claim may be valid under the applicable law, or

(b) believes to this effect in reliance upon the advice of counsel, sought in good faith and given after full disclosure of all relevant facts within his knowledge and information.153

This standard is both subjective and objective: the company must actually believe it has a valid defense and the belief must be reasonable.154

Applying this standard, evidence of the existence of probable cause arises where the insurance company or its counsel has performed a reasonable investigation of the facts of the particular case, the investigation has produced facts which provide a viable defense on the law or facts reasonably in dispute that, if true, would provide a viable defense, counsel has observed reasonable professional standards in investigating the law, and the actions taken in considering settlement and developing an effectuating a legal strategy are reasonable in light of the facts and law. Conversely, evidence of a lack of probable cause, in addition to the rare statements by company or counsel conceding the lack of a reasonable belief in the action taken, include a failure to fully investigate the facts and law relevant to the individual case, misrepresentations, destruction of evidence, filing a general denial in a case in which liability or special damages are clear, or a program of treating all cases of a certain type alike despite the potential for individual variation. In the case of the insurance company in particular, violations of provisions of an unfair claims settlement practices act are evidence of lack of probable cause. Unfair claims practices under the NAIC Model Act include:

Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under [insurance] policies;

Not attempting in good faith to effectuate prompt, fair

153. Restatement (Second) of Torts § 675. See Dobbs, supra note 94, at 1230.

and equitable settlement of claims submitted in which liability has become reasonably clear;

Compelling insureds or beneficiaries to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them... 155

The next element of the cause of action is that the defensive action be taken with malice or, in more modern terms, for an improper purpose. 156 The purpose of the civil justice system is the "proper adjudication" of claims; 157 bringing or defending a suit for any other purpose is a perversion of the system and provides the basis of a cause of action. Improper purpose is a subjective standard, speaking to the defendant's intent, but, as with other issues of intent, it can be inferred from objective evidence. 158

The Restatement comments suggest a number of typical situations of malicious prosecution in which improper purpose is clear, 159 and these can easily be related to malicious defense. First, "when the person bringing the civil proceedings is aware that his claim is not meritorious." 160 On the defense side, the identical situation arises when the company mounts a defense that it knows to be lacking in merit on the facts or law. This is an application of the maxim often applied to malicious prosecution that absence of probable cause gives rise to an inference of malice. 161

Second, "when the proceedings are initiated for the purpose of forcing a settlement that has no relation to the merits of the claim. This occurs, for example when a plaintiff, knowing that there is no real chance of successful prosecution of a claim, brings a 'nuisance suit' upon it for the purpose of forcing the defendant to pay a sum of money in order to avoid the financial and other burdens that a defense against it would put upon him." 162 On the defense side,

155. NAIC Model Act § 4 c-e.
156. Restatement (Second) of Torts § 674.
157. Id. § 676.
158. See Dobbs, supra note 94, at 1231 (making knowing or reckless falsehoods is evidence of improper purpose).
159. Restatement (Second) of Torts §676 cmt. c.
160. Id.
161. See Givelber, supra note 95, at 46.
162. Restatement (Second) of Torts § 676 cmt. c.
the analogous behavior occurs when the insurance company mounts a defense or refuses to settle to impose costs on the plaintiff with the purpose of coercing an unfairly low settlement. This behavior is also prohibited by the unfair claims settlement practices acts, as tactics that "compel insureds or beneficiaries to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them"\textsuperscript{163} or "make known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration."\textsuperscript{164}

Third, "when a defendant files a counterclaim, not for the purpose of obtaining proper adjudication of the merits of that claim, but solely for the purpose of delaying expeditious treatment of the original cause of action."\textsuperscript{165} Once the hurdle barring a wrongful litigation claim for defensive tactics is surmounted, there is no difference between delaying expeditious treatment by filing a counterclaim and by mounting an improper defense.

The third element of the malicious prosecution or defense action is that the prior action was terminated favorably to the plaintiff. This element requires that the prior action be finally resolved and that the judgment in favor of the plaintiff have been upheld on appeal, if any were brought. The requirement avoids relitigation of the facts of the prior case, limiting the scope of the wrongful litigation action and preventing the possibility of inconsistent verdicts. It also requires that the wrongful litigation be brought in a separate, subsequent proceeding and cannot be joined in the initial action.

In a malicious defense action, the requirement that the plaintiff have prevailed in the previous action removes a large class of insurance company intransigence from the scope of the tort. In many cases the insurance company will mount a defense or delay the case but eventually settle, often requiring a defendant under financial pressure to settle on less favorable terms than it

\textsuperscript{163} \textit{Model Unfair Claims Settlement Prac. Act} § 4.E.
\textsuperscript{164} Plitt & Kriegsfield, \textit{supra} note 57, at 1263-64 (internal quotations omitted).
\textsuperscript{165} \textit{Restatement (Second) of Torts} § 676 cmt. c.
might otherwise. Because a settlement is not an adjudication, the settlement is not a termination favorable to the plaintiff. Moreover, as a practical matter the company only will settle if it receives a release of all claims against it, which would include the wrongful litigation claim. Therefore, in these cases the malicious defense action will not be available. That does not mean, however, that it is of no value to the plaintiff. If a malicious defense action is available, it raises the company's potential cost and therefore raises the expected value of the litigation to the plaintiff. Subject to all the qualifications of the bargaining dynamics, this increase in expected value should cause some cases to go to trial that might not otherwise and others to settle for a higher value.

The final element of the malicious prosecution action in a minority of jurisdictions is that the plaintiff must have suffered "special injury" as a result of the previous litigation. It is common in litigation to suffer expense and emotional distress and, where the litigation is wrongfully brought, injury to reputation. The special injury requirement distinguishes this loss from the qualitatively different injury from, for example, seizure of property through court process. Jurisdictions that require special injury may be less receptive to the malicious defense tort, as they are to the basic tort of malicious prosecution.

2. Abuse of process. Abuse of process requires that one use an element of civil process in an improper way for an improper purpose. Unlike malicious prosecution, the evil here is not initiating litigation or obtaining process wrongfully, but misusing the process for a purpose for which it was not designed. Any use of civil process is likely to cause harm and provoke distress, but actual purpose, not just awareness, is required, and the use itself must be "so lacking in justification as to lose its legitimate function as a reasonably justifiable litigation procedure." Often

166. DOBBS, supra note 94, at 1234.
167. Id.
168. Id.
169. See RESTATEMENT (SECOND) OF TORTS § 682; DOBBS, supra note 94, at 1234.
170. Some courts require more than the ordinary use of the process, such as seizure of property, but most focus on the improper use rather than the particular form. DOBBS, supra note 94, at 1234-35; Mootz, supra note 75, at 490-503.
the improper purpose is collateral to the litigation, as where the
defendant attached the plaintiff's property to coerce the payment
of money not owed, but that is a common feature but not a
requirement.172 Bull v. McCloskey173 illustrates that the abuse
can take place in the context of a single suit.174 "Process," for
purposes of "abuse of process," has been variously defined; some
narrow definitions require the actual issuance of a writ or other
court order, but the more common approach is to regard "the
entire range of procedures incident to the litigation process" as
within its scope, including motions and discovery procedures as
well as court orders.175

As with malicious prosecution, cases have suggested that the
tort is not applicable to defensive tactics, but have seldom actually
held so.176 Two recent cases, Givens v. Mullikin177 and Crackel v.
Allstate Insurance Co.,178 both apply abuse of process to defensive
tactics and illustrate the kinds of behavior that insurance
companies frequently engage in to the detriment of accident
victims.

In general, the wrongful behavior in both cases was using the
pretrial process not for its proper purpose, "to bring out the facts
prior to trial so the parties will be better equipped to decide what
is actually at issue,"179 but "to wear the mettle of the opposing
party to reach a favorable termination of the cause unrelated to its
merits"180 or "as a 'club' in an attempt to coerce them, and other
similarly situated claimants, to surrender those causes of action

172. Restatement (Second) of Torts § 682 cmt. b; Dobbs, supra note 94,
at 1234.
173. 615 P.2d 957 (Nev. 1980).
174. Id.; See also Ace Truck & Equip. Rentals, Inc. v. Kahn, 746 P.2d 132
(Nev. 1987).
Mootz, supra note 75, at 508-11; William J. Appel, Annotation, Liability
Insurance: Third Party's Right of Action for Insurer's Bad-faith Tactics
177. 75 S.W.3d 383 (Tenn. 2002).
179. Givens, 75 S.W.3d at 402 (citing Ingram v. Phillips, 684 S.W.2d 954,
958 (Tenn. App. 1984)).
180. Id.
that sought only modest damages."181

In *Givens* the wrong was discovery abuse.182 The defendant law firm (for which the insurance company was vicariously liable because of its direction of the process) issued more than 230 interrogatories and subjected the plaintiff to a lengthy deposition even though much of the information sought was "either already in the defendant's possession, not relevant to the issues in litigation, or otherwise not reasonably calculated to lead to discoverable information."183 The firm also issued more than seventy subpoenas for medical records and other documents containing information embarrassing to the plaintiff not relevant to the case, and for privileged information from the plaintiff's psychologist.184

In *Crackel*, Allstate had developed a scheme to limit its liability for "minor-impact, soft-tissue" (MIST) claims in a manner that demonstrated abuse of process, in part, because of the failure to individualize claims.185 The scheme involved making unreasonably low offers and taking many cases to trial to make the claims economically unfeasible for victims' attorneys and to present obstacles to "a realistic settlement."186 In the particular case, for example, Allstate presented an offer-of-judgment of $101 even though it knew that its insured was one hundred percent negligent, and the plaintiffs had documented medical expenses of $1,600. It also required the plaintiffs to submit to medical evaluations even though they had not sought or received any care after the initial accident. Allstate took the position in arbitration that the case had no value, appealed the arbitration award that its adjuster conceded was "not bad." Finally, it failed to file a complete pretrial memorandum and participate in good faith in a mandatory settlement conference.187

182. 75 S.W.3d at 391.
183. *Id.* at 402.
184. *Id.* at 402-03.
185. 92 P.3d at 890.
186. *Id.*
187. One bar to the application of abuse of process in some jurisdictions is a broad litigation privilege for statements or conduct. Traditionally the litigation privilege protected statements made in the course of litigation, particularly statements by witnesses, against further actions, notably but not exclusively actions for defamation. 86 C.J.S. *Torts* § 36 (2006); *Restatement*
CONCLUSION

Conservatives and business interests marching under the banner of tort reform have substantially undermined tort law's objectives of promoting safety, compensating injuries, and furthering fairness. Genuine tort reform should focus on issues in which those objectives are inadequately served and devise solutions to promote the objectives. The actions of insurance companies in delaying and denying fair treatment of justified personal injury claims presents such an issue. The history of tort law demonstrates the ability of courts and legislatures to adapt existing doctrines and to create new doctrines to solve problems and serve the public interest in a vibrant body of tort law. The adoption of the measures proposed in this article will help restore balance to tort law and promote safety, compensation, and fairness.

(SECOND) OF TORTS § 587. A few jurisdictions, of which California is the most notable, have gone much farther, immunizing acts as well as statements and thereby essentially eviscerating the abuse of process tort. See Mootz, supra note 75, at 496-98.