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Torts—Tort of Bad Faith in First Party Actions Recognized

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TORTS - TORT OF BAD FAITH IN FIRST PARTY ACTIONS

Broadway Arms Corporation sued its insurer, Aetna Casualty and Surety Company, alleging that Aetna committed the tort of bad faith in its handling of Broadway Arms' claim under a fire insurance policy. Aetna appealed from a jury verdict finding that Aetna had acted in bad faith and assessing compensatory damages of $175,000 and punitive damages of $5,000,000.

The fire occurred on August 22, 1981, and forced the shut-down of Broadway Arms' gun shop. Several days after the fire, Aetna advanced Broadway Arms $30,000, as partial payment on the loss. The parties became embroiled in a dispute over the ownership of salvage from the fire and relations between Broadway Arms and Aetna deteriorated. Aetna offered $63,225 for settlement of all claims under the policy. Broadway Arms rejected this offer and filed suit on December 4, 1981.

At trial, Broadway Arms argued that Aetna was guilty of bad faith because of (1) its refusal to pay policy limits under the fire coverage; (2) its failure to release the salvage to insured; and (3) a threat by Aetna to report the amount of Broadway Arms' claimed losses to the Internal Revenue Service. On appeal, Aetna argued that the Arkansas

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1. The insurance policy included basic coverage for business property losses up to $75,000; a provision for an automatic 25% increase in the basic coverage during a specified peak season; and coverage for earnings lost during any shut-down occasioned by fire. See Supplemental Abstract and Brief for Appellee at 1-2, Aetna Casualty and Sur. Co. v. Broadway Arms Corp., 281 Ark. 128, 664 S.W.2d 463 (1984).

2. Broadway Arms employed attorney Roger Glasgow to handle negotiations with Aetna. Prior to trial, Glasgow determined that his testimony as to Aetna's actions in handling Broadway Arms' claims might be necessary to establish bad faith. Accordingly, Glasgow associated attorney Gary Eubanks to handle the case, agreeing to split a contingent fee. Glasgow withdrew as attorney of record, but he continued to represent Broadway Arms in other suits brought against it, and was designated corporate representative for Broadway Arms, sitting at counsel table during the course of the trial of the suit against Aetna. See Supplemental Abstract and Brief for Appellee at 52-56, Aetna Casualty and Sur. Co. v. Broadway Arms Corp., 281 Ark. 128, 664 S.W.2d 463 (1984). The court held that Glasgow, under the circumstances of the case, should not have been permitted to testify. In so holding, the court reaffirmed its position that a lawyer with an interest in the outcome of a case should not be allowed to participate as a witness. However, the court directed that Glasgow should be allowed to testify upon retrial of the case, provided that he withdraw completely from the conduct of the case. For Glasgow's account of the lawsuit and of his own role in it, see Glasgow, First Party Bad Faith Comes to Arkansas, 18 ARKANSAS LAWYER 48 (1984).
Trade Practices Act\(^3\) and the penalty and fees statute\(^4\) preempted the bad faith cause of action, and that the trial court erred in instructing the jury that violation of the Trade Practices Act was evidence of bad faith.\(^5\)

The Arkansas Supreme Court, in an opinion written by Justice Purtle, rejected Aetna's argument that the statutory enactments\(^6\) which regulate the insurance industry within the state preempt the bad faith cause of action in tort. The court held that the bad faith cause of action is viable in first party as well as in third party cases. In first party actions the bad faith tort requires a showing of affirmative misconduct by an insurer which is dishonest, malicious or oppressive. However, the court reversed and remanded the case, finding that the trial court erroneously instructed the jury as to the implications of the Trade Practices Act.\(^7\) The court stated that the trial judge omitted an important part of the statutory language in his instruction,\(^8\) and further held that the instruction should not have stated that violation of the Act is evidence of bad faith. *Aetna Casualty and Surety Co. v. Broadway Arms Corp.*, 281 Ark. 128, 664 S.W.2d 463 (1984).

Disputes arising between insured and insurer have traditionally been governed by the law of contract.\(^9\) Accordingly, an insured seeking to recover against the insurer for simple breach of contract is confronted at the outset by the well-established principle that only those consequences of the breach which were foreseeable at the time of the making of the contract are compensable.\(^10\) Applied to the contract of

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5. Aetna also argued that (1) the trial court erred in allowing Glasgow to testify; (2) the damages awarded were excessive and not supported by substantial evidence; and (3) the trial court erred in failing to grant a new trial upon Aetna's proffer of affidavits from two jurors showing jury prejudice.
8. See infra notes 113, 114 and accompanying text. The trial judge omitted a prefatory section which states: "Committing or performing with such frequency as to indicate a general business practice, any of the following . . . ." Ark. Stat. Ann. § 66-3005(9) (1980).
10. This principle was first recognized in Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854), and is today the guiding tenet for courts awarding damages for breach of contract. See J. Calamari & J. Perillo, The Law of Contracts § 14-5 (2d ed. 1977). The rule set forth in *Hadley* limits recovery for breach of contract to those elements of harm which were reasonably
indemnity between insurer and insured, this familiar rule of contract law has meant that the insured's damages are limited to the amount of the policy, plus interest.\textsuperscript{11}

In an ordinary insurance claim case, the applicable law of contract would bar recovery for such "unforeseeable" consequential damages as emotional distress or mental anguish resulting from the breach.\textsuperscript{12} Even claimed pecuniary losses, such as loss of business profits, could be denied compensation in those jurisdictions taking the strict view that recovery for breach of an insurance contract should be held to policy limits.\textsuperscript{13} Nor are punitive damages ordinarily allowed for breach of contract, no matter how willful, malicious or fraudulent the breach.\textsuperscript{14}

Such limitations on the recoverable damages stemming from breach of an insurance contract sometimes resulted in harsh decisions\textsuperscript{15} and placed the insured at a distinct disadvantage in a dispute over settlement of a policy claim. In situations where the amount of the claim was small and the financial resources of the insured limited, the insurance company often could force a settlement below the policy limit simply by delaying action on the claim.\textsuperscript{16}


\textsuperscript{12} E.g., Jefferson County Burial Soc. v. Curry, 237 Ala. 548, 187 So. 723 (1939) (recovery for breach of burial policy limited to damages not exceeding the stipulated value of burial services to be rendered despite allegations as to consequential damages suffered including mental distress); Clark v. Life & Casualty Ins. Co., 245 Ky. 579, 53 S.W.2d 968 (1932) (breach of burial insurance policy did not allow recovery of consequential damages for mental anguish when there was no physical injury).


\textsuperscript{15} See, e.g., Meridian Mutual Ins. Co. v. McMullen, 152 Ind. App. 141, 282 N.E.2d 558 (1972). There the court refused to allow the insured to recover damages beyond the amount due under a fire insurance policy. The insured claimed that the failure of his insurer to pay promptly for fire loss to his home resulted in his losing a job and contracting heart disease and ulcers. The court held that as a matter of law such damages were not recoverable in a breach of contract action because they were too remote and not within the reasonable contemplation of the parties at the time of the making of the contract.

\textsuperscript{16} Insurers always have had nearly insurmountable control over insureds. They wrote the policies; they interpreted the policies; they knew the policies inside and out; they
Dissatisfaction with the recovery limitations imposed under a traditional contract approach led counsel for plaintiffs to press their claims to extra-contractual damages on a variety of legal theories.\textsuperscript{17}

Some courts responded by adopting a liberal view of the foreseeability requirement for consequential damages, thus allowing recovery by the insured for damages in excess of policy limits.\textsuperscript{18} Other courts awarded extra-contractual damages based upon proof of an independent tort, including that of fraud,\textsuperscript{19} intentional infliction of emotional distress,\textsuperscript{20} and bad faith.\textsuperscript{21}

These differing approaches, one proceeding in contract, the other in tort, might naturally be expected to generate some confusion as to the principles to be applied in an insurance case where extra-contractual damages are sought. Where the claimed basis for extra-contractual recovery is bad faith, the problem of mixed contract and tort theories is exacerbated. It is the breach of a duty created by contract (that of good faith and fair dealing in handling claims) which gives rise to the cause of action in tort.\textsuperscript{22} Thus, the basis for the so-called "new tort" of bad faith in insurance cases is a combination of tort and contract principles.\textsuperscript{23}

The contractually created duty of good faith and fair dealing,
upon which the tort of bad faith is based, has not always been recognized by the courts as part of the obligations naturally arising out of a contract of insurance.\textsuperscript{24} The earliest cases\textsuperscript{25} to recognize such a contract duty involved third party claims in liability insurance cases, i.e., disputes between an insurer and its insured over the manner in which the insurer had handled, settled or failed to settle claims made against the insured by third parties.\textsuperscript{28}

The origin of the concept as it is applied today in first and third party insurance cases is generally traced to a 1914 New York decision, Brassil v. Maryland Casualty Co.\textsuperscript{27} In Brassil, the insurance company refused an offer from a third party suing its insured to settle the claim for $1,500, the amount of the policy. A judgment was entered against the insured for $6,000. The insurance company refused to appeal the judgment, but offered to pay its insured the amount of the policy. The insured thereupon hired his own attorney and won a reversal. He then sued the insurer to recover his legal costs. The Brassil court held that the insurer had violated an obligation of good faith which underlies all contracts and was therefore liable for the expenses which the insured had incurred in prosecuting the appeal.\textsuperscript{28}

\textsuperscript{24} For example, in the context of liability insurance, where an insured was sued by a third party, the early cases often stated that an insurer was under no duty to accept an offer to settle the claim within policy limits. Under this view, neither a negligent nor a bad faith refusal to accept a settlement offer would subject the insurer to liability. \textit{E.g.}, Rumford Falls Paper Co. v. Fidelity and Casualty Co., 92 Me. 574, 43 A. 503 (1899); C. Schmidt & Sons Brewing Co. v. Travelers Ins. Co., 244 Pa. 286, 90 A. 653 (1914). Contrast this approach to the one taken in Johansen v. California State Auto Ass'n Inter-Ins. Bureau, 15 Cal. 3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975), which seems to border on strict liability for refusal by an insurer to settle a third party claim following an offer that is within the policy limits.

\textsuperscript{25} \textit{E.g.}, Manhattan Fire Ins. Co. v. Weill & Ullman, 69 Va. (28 Gratt.) 389 (1877); Germania Ins. Co. v. Rudwig, 80 Ky. 223 (1882).


\textsuperscript{27} 210 N.Y. 235, 104 N.E. 622 (1914).

\textsuperscript{28} Ironically, the declaration in Brassil of a covenant of good faith and fair dealing implicit in the contract of insurance seems to have been prompted, at least in part, by the arguments of the insurer that the insured was obligated to deal fairly and in good faith with the insurance company. As the court noted in Brassil,

Even the defendant has invoked this implied obligation of good faith and fair dealing not expressed in the terms of its written contract, for by its answer it has set forth that it was incumbent upon the plaintiff to "deal fairly and in good faith . . . and that he should not voluntarily or knowingly do any acts which would impose or tend to impose on him or on this defendant a loss in the premises." If this was the plaintiff's duty, it was not less the correlative obligation of the defendant to "deal fairly and in good faith" with him.

210 N.Y. at 237, 104 N.E. at 624. This passage of the court's opinion prompted one lawyer practicing in the field to comment that "it seems the insurance industry was hoist with its own
Brassil illustrates several factors important to an analysis of the origins of the bad faith cause of action in tort. First, it shows the contractual genesis for the action, and second, it serves to demonstrate the important distinction which must be made between first party and third party actions in considering the tort of bad faith.\textsuperscript{29} Brassil is the root decision in a long line of cases holding the insurer liable in excess of policy limits for a bad faith refusal to accept a reasonable offer of settlement in the third party claim setting.\textsuperscript{30} Extra-contractual liability based on the breach of a covenant of good faith and fair dealing in a first party insurance case is a relatively recent development,\textsuperscript{31} and one which is conceptually an extension of the doctrine of good faith as applied in the third party cases.\textsuperscript{32} Accordingly, it is important to preface a consideration of the tort of bad faith in first party cases with a review of the major decisions in the third party actions, from which the theory of good faith and fair dealing arose.

The principle that an insurer, by reason of the contract of insurance, owes a duty of good faith and fair dealing in its handling of policy claims and settlements is widely recognized in the context of third party claims.\textsuperscript{33} Extra-contractual damages for breach of such a duty

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\textsuperscript{29} See Annot., 40 A.L.R. 2d 168, 178-80 (1955).

\textsuperscript{30} Wetherbee v. United Ins. Co. of Am. 265 Cal. App. 2d 921, 71 Cal. Rptr. 764 (1968) has been cited as the initial case finding an insurer liable for a judgment in excess of policy limits in a first party action. Holmes, supra note 29, at 526. However, the extra-contractual award in Wetherbee was based on a showing of fraud. It was not until 1973 that a court based an award of extra-contractual damages in a first party case upon the finding of a bad faith tort. Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal Rptr. 480 (1973).


\textsuperscript{32} See Annot., 40 A.L.R. 2d 168, 178-80 (1955) for an extensive annotation of cases from the overwhelming majority of jurisdictions.
were awarded in court decisions as early as 1915.\textsuperscript{34}

In Arkansas, the question of whether an insurer could be held liable for a bad faith refusal to settle a claim against the insured was first addressed in the 1954 case of \textit{Home Indemnity Co. v. Snowden}.\textsuperscript{35}

The insurer in \textit{Snowden} had issued a liability policy in the amount of $5,000 covering accidents arising out of Snowden's operation of a frozen food locker business. During installation of a refrigerator compressor at one of Snowden's plants, a refrigeration man was killed. The widow offered to settle her wrongful death claim for $8,000. Snowden requested that the insurer contribute $5,000 to the settlement. When the insurer refused, Snowden made full settlement of the claim and proceeded to sue the insurer for reimbursement. The court held that where an insurer "assumes the duty of defending or settling suits against the insured, this obligation is one requiring due care and a strict performance in utmost good faith."\textsuperscript{36} The insurer was liable for any damage to the insured resulting from a bad faith refusal of the insurer to compromise the claim involved. The court noted that "[w]hile the insured is generally prohibited from making a settlement of a claim under policies giving that right to the insurer, a different rule obtains where the insurer itself, in bad faith, breaches the contract by arbitrarily refusing to settle."\textsuperscript{37} Accordingly, the court awarded Snowden recovery against the insurer in the amount of $5,000.

The Arkansas court and others adopting the doctrine of good faith and fair dealing in third party cases did not, in the earlier cases, carefully distinguish between a cause of action sounding in tort and one sounding in contract.\textsuperscript{38} California courts took the lead in enunciating the principles of a tort cause of action in insurance cases.\textsuperscript{39} In the 1958 case of \textit{Comunale v. Traders & General Insurance Co.},\textsuperscript{40} the California court considered the question of extra-contractual recovery by a third party claimant following a refusal by the insurer to settle a claim within the policy limits. The insured had assigned his rights under the

\begin{itemize}
  \item \textsuperscript{34} Schencke Piano v. Philadelphia Casualty Co., 216 N.Y. 662, 110 N.E. 1049 (1915);
  Wisconsin Zinc Co. v. Fidelity and Deposit Co., 162 Wis. 39, 155 N.W. 1081 (1916).
  \item \textsuperscript{35} 223 Ark. 64, 264 S.W.2d 642 (1954).
  \item \textsuperscript{36} \textit{Id.} at 70, 264 S.W.2d at 645 (quoting 29 AM. JUR. Insurance § 1077 (1940)).
  \item \textsuperscript{37} \textit{Id.}
  \item \textsuperscript{38} The Arkansas court in \textit{Snowden} limited recovery to the amount of the policy coverage. It should be noted that Justice Millwee, writing for the court in \textit{Snowden}, apparently held the view that Snowden should have been allowed to recover the full $8,533.85 judgment. \textit{Id.} at 71, 264 S.W.2d at 646.
  \item \textsuperscript{40} 50 Cal. 2d 654, 328 P.2d 198 (1958).
\end{itemize}
policy to the third party claimant who had obtained a judgment against the insured. The court held that in every insurance contract there is an implied covenant of good faith and fair dealing which obligates the insurer to refrain from any act that might injure the right of the insured to receive the benefits of the agreement. Breach of this covenant, the court said, gives rise to a cause of action not only in contract but in tort as well, allowing the insured to choose between recovery based on contract or tort damages.

Recognition of the tort basis for awarding extra-contractual recovery was important in the subsequent California case of *Crisci v. Security Insurance Co.* In *Crisci*, the court allowed recovery against an insurer not only of the $101,000 verdict against its insured, but also $25,000 for her mental suffering, which resulted from wrongful refusal of the insurer to settle within the policy limits.

The Arkansas court also has made it clear that the cause of action for extra-contractual damages in a third party claim case is one sounding in tort. In *Tri-State Insurance Co. v. Busby*, the court considered an appeal by the insurer from a lower court judgment awarding extra-contractual damages to its insured following a wrongful refusal by the insurer to settle a claim within the policy limits. Citing its earlier holding in *Southern Farm Bureau Casualty Insurance Co. v. Hardin* for the proposition that a third party claim sounds in tort, rather than in contract, the court noted that “[t]he action is one in tort and interest should be allowed only from the date of the judgment in the case at bar.”

California became the first jurisdiction to extend the tort of bad

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41. *Id.* at 658, 328 P.2d at 200.
42. *Id.* at 663, 328 P.2d at 203.
43. 66 Cal. 2d 425, 426 P.2d 173, 58 Cal. Rptr. 13 (1967).
44. The court in *Crisci* noted that *Comunale v. Traders & Gen. Ins. Co.*, 50 Cal. 2d 654, 328 P.2d 198 was mainly concerned with the contract aspect of the action. This may be due to the facts that the tort duty is ordinarily based on the insurer’s assumption of the defense and of settlement negotiations [citations deleted] and that in *Comunale* the insurer did not undertake defense or settlement but denied coverage. In any event *Comunale* expressly recognizes that “wrongful refusal to settle has generally been treated as a tort.” *Id.* at 432 n.3, 426 P.2d at 178 n.3, 58 Cal. Rptr. at 18 n.3 (1967).
45. 251 Ark. 568, 473 S.W.2d 893 (1971).
46. 233 Ark. 1011, 351 S.W.2d 153 (1961).
47. 251 Ark. at 572, 473 S.W.2d at 896.
48. Earlier California cases, while discussing such an extension, based their holdings for the insured in a first party claim case, on grounds different from the bad faith cause of action. See, *e.g.*, *Wetherbee v. United Ins. Co. of Am.*, 265 Cal. App. 2d 921, 71 Cal Rptr. 764 (1968) (fraudulent misrepresentation); *Fletcher v. Western Nat’l Life Ins. Co.*, 10 Cal. App. 3d 376, 89
faith from third party to first party cases in *Gruenberg v. Aetna Insurance Co.*49 This case involved a claim to indemnity under the terms of a fire insurance policy. The insurer refused to settle the claim and gave reports to the police which falsely implied that Gruenberg had been guilty of arson. As a consequence, Gruenberg, who was attempting to avoid arrest on the criminal charge, was unable to appear for an examination under oath as required by the terms of his insurance policy.50 When the insurer denied coverage, citing this breach of the policy terms, Gruenberg filed suit alleging that the insurer’s bad faith refusal to settle the claim resulted in the loss of his business and infliction of emotional distress.51 The court held that an insurer which unreasonably fails to pay benefits owing to an insured under the policy terms thereby breaches an implied duty of good faith and fair dealing, making the insurer liable for the commission of an independent tort of bad faith,52 which permits the insured to recover both compensatory and punitive damages.53

The Arkansas Supreme Court first considered the tort of bad faith in a first party context in *Findley v. Time Insurance Co.*54 In *Findley*, the plaintiff sued her insurer alleging a bad faith refusal to pay benefits under a major medical insurance policy. Specifically, the insured alleged that the insurer had failed to explain its refusal to pay benefits, had failed to investigate the claim fully, and had failed to contact the plaintiff or her physician.55 While discussing the evolving new tort of bad faith, the court in *Findley* was able to avoid the issue because the plaintiff’s complaint did “not assert any affirmative action on the part of the defendant that would constitute bad faith. . . .”56 The court concluded that although it did not rule out the possibility of a separate cause of action in tort, “[s]uch questions we leave to the future.”57 The bad faith tort was not recognized until six years later in *Aetna Casualty and Surety Co. v. Broadway Arms Corp.*58

Not all courts which have recognized the tort of bad faith in a


50. See id. at 571, 510 P.2d at 1035, 108 Cal. Rptr. at 483.
51. Id. at 572, 510 P.2d at 1041, 108 Cal. Rptr. at 483.
52. Id. at 581, 510 P.2d at 1042, 108 Cal. Rptr. at 490.
53. Id. at 580, 510 P.2d at 1041, 108 Cal. Rptr. at 489.
54. 264 Ark. 647, 573 S.W.2d 908 (1978).
55. Id. at 652-53, 573 S.W.2d at 910-11.
56. Id. at 653, 573 S.W.2d at 911.
57. Id. at 655, 573 S.W.2d at 912.
third party action have been willing to extend the cause of action to first party cases. Such courts reason that the bad faith theory of recovery should be applied only in third party cases, pointing out that in a third party liability case, the insurer and its insured stand in a fiduciary relationship. The insurer has complete control over the defense of a lawsuit filed against its insured by the third party claimant. In this situation, the failure of the insurer to accept a reasonable offer of settlement could result in a judgment against the insured which is in excess of the policy coverage. In first party cases, however, the insurer and the insured are essentially in an adversarial stance—the insured claiming he is owed money under the policy, the insurer claiming that he is not.

Other courts have rejected the tort of bad faith on grounds that certain statutory remedies have preempted the field, dispensing with the need for any separate remedy in tort. Thirty-two jurisdictions, including Arkansas, have statutes patterned after the Model Unfair Trade Practices Act, which sets out certain insurance practices as prohibited and provides that violation of the Act may result in adminis-

59. See Karp, supra note 26, at 83.
62. Id. at 656.
63. See Best, Statutes and Regulations Controlling Life and Health Insurance Claim Practices, 29 DEFENSE L.J. 115 (1980); and Best, Statutes and Regulations Controlling Life and Health Insurance Claim Practices—An Update, 31 DEFENSE L.J. 93 (1982) for an excellent compilation of information on the various statutory regulation schemes and their effects on insurance.
64. See Best, Statutes and Regulations Controlling Life and Health Insurance Claim Practices, 29 DEFENSE L.J. 115, 117-18 (1980) (includes a description of the deviations in each jurisdiction from the Model Unfair Trade Practices Act (National Ass'n of Ins. Commissioners 1947)).
65. Ark. Stat. Ann. §§ 66-3002 to -3014 (1980). Section 66-3005(9) describes the trade practices for which sanctions may be imposed. Section 66-3012 establishes the penalties which may be assessed against an insurer who violates a cease and desist order from the Commissioner, as authorized in §66-3008. The section was amended in 1981 to increase the maximum penalties from $5,000 to $10,000. Ark. Stat. Ann. §66-3012(a) (Supp. 1983).
trative penalties to be imposed by a commissioner of insurance. Courts in several states have construed these provisions for administrative penalties as evidence of a legislative intent to establish an exclusive remedy for an insurer’s unfair or unreasonable trade practices. Interestingly, other state courts have held that the Unfair Trade Practices Act, rather than precluding an action in tort, actually creates a private cause of action against the insurer. It should be noted that the Arkansas Trade Practices Act was amended in 1981 expressly to disclaim any legislative intent for or against either statutory preemption or creation of a private cause of action.

In addition to administrative penalties, several states, including Arkansas, have specific penalty and fees statutes which award an extra-contractual recovery to the insured in cases involving certain prohibited claim practices. A number of jurisdictions have held that such statutory remedies preempt the cause of action in tort. Conversely, several states have rejected the insurer’s claim that the statutory remedy preempts the bad faith tort.

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67. See, e.g., Spencer v. Aetna Life and Casualty Ins. Co., 227 Kan. 914, 611 P.2d 149 (1980), where the court said, “The legislature has provided several remedies for an aggrieved insured and has dealt with the question of good faith first-party claims . . . Where the legislature has provided such detailed and effective remedies, we find it undesirable for us to expand those remedies by judicial decree.” 227 Kan. at 926, 611 P.2d at 158. See also Duncan v. Andrew County Mut. Ins. Co., 665 S.W.2d 13 (Mo. Ct. App. 1983); Lawton v. Great Southwest Fire Ins. Co., 118 N.H. 607, 392 A.2d 576 (1978).


71. ARK. STAT. ANN. § 66-3238 (1980) provides that failure to pay a claim within the time specified in the policy after demand is made will expose the insurer to liability, beyond the contractual benefits due, in the amount of 12% of the contractual benefits due, in addition to attorney’s fees.


The first Arkansas case to raise the preemption question was *MFA Mutual Insurance Co. v. Keller*, where the court expressly reserved the issue. In 1980, the Eighth Circuit Court of Appeals, in a case arising in Arkansas, observed that "[a]pparently the view is slowly spreading that states will have either the bad faith tort or the statutory penalty, but not both." Despite this conjecture, the Arkansas Supreme Court in *Aetna Casualty and Surety Co. v. Broadway Arms Corp.*, held, as previously noted, that the statutory remedies provided by the Trade Practices Act and the Arkansas penalty and fees statute do not preempt the bad faith tort action.

Arkansas's penalty and fees statute differs from those of a number of states in that the statute provides for a penalty for late payment regardless of the existence of reasonable cause in denying the claim. The Arkansas statute penalizes the insurer for failing to pay a claim within the time specified in the policy after demand is made. In Louisiana, the failure to pay must be without reasonable cause; in Illinois, the penalty is awarded only for vexatious and unreasonable delay; in Georgia and in Tennessee bad faith is required for assessment of the penalty; and in Missouri, a penalty is imposed only for unreasonable refusal to pay. It has been argued that the absence in the Arkansas statute of any reference to bad faith or unreasonable behavior on the part of the insurer is evidence that the legislature did not intend the penalty and fees statute to preempt an action in tort. Tennessee courts, despite a statute which contains a requirement of bad faith as a basis for the penalty, have recognized an independent bad faith cause of action.

57. 393 N.E.2d 1171 (1979).
59. *Id.* at 286, 623 S.W.2d at 843.
62. *See supra* note 71.
63. *See infra* notes 82-86 and accompanying text.
65. *Id*.
72. *Id.*
74. *See MFA Mutual Ins. Co. v. Flint*, 574 S.W.2d 718 (Tenn. 1978); *Brown v. St. Paul*
This same diversity of approaches characterizes the court opinions which have set out the elements of the tort.\textsuperscript{90} In considering the standards which courts have applied in holding an insurer liable under a bad faith theory, it is again important to distinguish between third and first party cases. In the third party actions, the tort ranges from negligence in some jurisdictions\textsuperscript{91} to something very much like strict liability in others.\textsuperscript{92} In the context of first party actions, however, some courts have adopted a reasonableness test\textsuperscript{93} while others have insisted upon a showing of malicious, oppressive or dishonest conduct indicative of an intentional tort.\textsuperscript{94}

The Arkansas Supreme Court also has established a dichotomy between first and third party claims. In the third party setting, the Arkansas court has adopted a standard which equates negligence with bad faith. In \textit{Southern Farm Bureau Casualty Insurance Co. v. Parker},\textsuperscript{95} the insurer appealed a lower court award of damages for its failure to settle a claim against its insured which was within the policy limits. The insurer argued that liability in a third party claim action should not be predicated upon negligence alone.\textsuperscript{96} The Arkansas Supreme Court, in affirming the lower court said that the insured could be held liable under either theory, noting that “[s]ome courts allow recovery on the rule of ‘bad faith’, while other courts allow recovery on the less stringent rule of negligence. We see no occasion to align Arkansas exclusively with either of these...”\textsuperscript{97}

This “either-or” approach was followed in \textit{Tri-State Insurance Co. v. Busby},\textsuperscript{98} where the court said, “[I]t is well established in our state

\textsuperscript{90} See infra notes 91-94 and accompanying text.
\textsuperscript{92} See, e.g., Johansen v. California State Automobile Ass’n Inter-Ins. Bureau, 15 Cal.3d 9, 538 P.2d 744, 123 Cal. Rptr. 288 (1975).
\textsuperscript{93} See, e.g., Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978). “The tort of bad faith can be alleged only if the facts pleaded would, on the basis of an objective standard, show the absence of a reasonable basis for denying the claim, i.e., would a reasonable insurer under the circumstances have denied or delayed payment of the claims under the facts and circumstances.” Id. at 692, 271 N.W.2d at 377. See also United States Fidelity & Guar. Co. v. Peterson, 91 Nev. 617, 540 P.2d 1070 (1975).
\textsuperscript{95} 232 Ark. 841, 341 S.W.2d 36 (1960).
\textsuperscript{96} Id. at 846, 341 S.W.2d at 39.
\textsuperscript{97} Id. at 846, 341 S.W.2d at 40.
\textsuperscript{98} 251 Ark. 568, 473 S.W.2d 893 (1971).
that an insurer is liable to its insured for any judgment in excess of the insured's policy limits if the insurer's failure to settle the claim was due to fraud, bad faith, or negligence. In *Members Mutual Insurance Co. v. Blissett,* the court permitted an insured to recover for a negligent failure of the company to settle a claim against its insured.

By contrast, the court has made it clear that negligence or misfeasance is insufficient to establish the tort of bad faith in first party actions. Affirmative misconduct which is malicious, oppressive or dishonest is required. Although the standards for judging whether an insurer’s conduct amounted to bad faith may vary from jurisdiction to jurisdiction, there is greater agreement among the courts as to the elements necessary to sustain an award of punitive damages once the bad faith tort has been established. Even in those jurisdictions applying a reasonableness test for bad faith an award of punitive damages requires that the plaintiff prove more than breach of a duty of good faith. A showing of oppression, fraud or malice on the part of the insurer is required for an award of punitive damages.

*Aetna Casualty and Surety Co. v. Broadway Arms Corp.* made it clear that in Arkansas a showing of malicious, oppressive or dishonest conduct by the insurer is essential to establish a prima facie case in a first party action. The court specifically rejected the notion that negligence or bad judgment on the part of the insurer would suffice to show bad faith. In a separate opinion, Justice Hickman noted that, although the majority's formulation of the test for bad faith imposed "a heavy burden on an insured," he would go further and "characterize the new tort as outrage, because it better describes the kind of conduct

99. *Id.* at 569, 472 S.W.2d at 894.
100. 254 Ark. 211, 492 S.W.2d 429 (1973).
102. See cases cited *supra* note 60.
103. *See, e.g., Anderson v. Continental Ins. Co.,* 85 Wis.2d 675, 271 N.W.2d 368 (1978). "For punitive damages to be awarded, a defendant must not only intentionally have breached his duty of good faith, but in addition must have been guilty of oppression, fraud, or malice. . . . " *Id.* at 686, 271 N.W.2d at 379. *See also* Lynch v. Mid-America Fire and Marine Ins. Co., 94 Ill. App. 3d 21, 418 N.E.2d 421 (1981). "No case has been called to our attention holding that evidence supporting an award of compensatory damages for an insurer's failure to settle the claim in good faith necessarily supports an award for punitive damages." *Id.* at 28, 418 N.E.2d at 428. *Accord,* Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638 (N.D. 1979); Bibeault v. Hanover Ins. Co., 417 A.2d 313 (R.I. 1980).
105. *Id.* at 133, 664 S.W.2d at 465.
106. *Id.* at 138, 664 S.W.2d at 468.
107. *Id.* at 139, 664 S.W.2d at 468.
that should result in punishment." He expressed concern that "bad faith" could well be interpreted by jurors as mere negligence when "this tort is not one of negligence — it is one of intentional malicious, dishonest and oppressive conduct." Justice Hickman concluded that the evidence presented in the case was insufficient to show outrageous conduct on the party of Aetna.

Although the court affirmed the feasibility of an action in tort based on bad faith, it nevertheless reversed the judgment of the trial court, finding error on several points. The court first dispensed with Aetna's claim that the provisions of the Trade Practices Act and the penalty and fees statute preempt the cause of action in tort. The court noted that such an interpretation of the statutory provisions was erroneous because neither of the statutory remedies deals with the problem of bad faith. Further, the court noted that interpreting the statutes as providing for an exclusive remedy would rule out third party claims of bad faith since "the Trade Practices Act is only an effort to clean up undesirable conduct of insurers and the penalty and fees statute applies only to first party claims."

Justice Purtle, writing for the court, then considered Aetna's objection to a jury instruction concerning the Trade Practices Act. The Act sets out certain practices of an insurer which will be considered "unfair" and provides for the assessment of administrative penalties in the event of a violation. In reading the applicable portions of the statute to the jury, the trial judge omitted a prefatory section of the statute which states, "[C]ommitting or performing with such frequency as to indicate a general business practice, any of the following..." will be considered an unfair practice. Because the trial judge omitted what the court characterized as "a vital portion of the statute," and because the judge improperly stated that violation of the statute was evidence of bad faith, the court upheld Aetna's objections to the jury instructions.

After reviewing Broadway Arms' three specific allegations of bad faith, the court held that, as a matter of law, the evidence did not sustain the finding that Aetna acted dishonestly, maliciously or oppres-

108. Id. at 139, 664 S.W.2d at 469.
109. Id. at 140, 664 S.W.2d at 469.
110. Id.
111. Id. at 133, 664 S.W.2d at 465.
112. Id.
115. Aetna, 281 Ark. at 135, 664 S.W.2d at 466.
sively in its handling of the salvage dispute.\(^{116}\) On the question of the alleged threat by Aetna to report Broadway Arms' insurance claim to the IRS,\(^{117}\) the court directed the trial court to determine upon remand whether such a threat constituted bad faith on the part of the insurer.\(^{118}\)

*Aetna Casualty and Surety Co. v. Broadway Arms Corp.* is significant in several respects. First, the opinion clearly established the viability of the bad faith cause of action in a first party context. The 1978 opinion in *Findley v. Time Insurance Co.*,\(^{119}\) referred to the tort only in dicta and left unanswered the question of whether the court would in fact recognize the tort.\(^{120}\)

Second, the opinion indicates that the Arkansas court will insist upon truly egregious conduct on the part of an insurer as a prerequisite to imposition of liability in tort. Although other jurisdictions have permitted the assessment of extra-contractual damages upon a showing of conduct which might be called aggravated negligence,\(^{121}\) *Aetna* rejected the negligence standard.

While some commentators have questioned the wisdom of extending the bad faith cause of action from third to first party cases,\(^{122}\) the Arkansas formulation of the tort seems likely to have a beneficial impact. Although the insurance industry as a whole has regarded the bad faith tort as a malevolent invention of fee-hungry lawyers,\(^{123}\) it is doubtful whether the Arkansas formula, as announced in *Aetna*, will seriously disturb the conscientious insurer.

Finally, *Aetna* is important because it soundly rejected the contention that the penalties provided by statute for refusal by an insurer to pay a claim or the administrative sanctions permissible under the Trade Practices Act, preempt the cause of action in tort. The issue is more important than the court's cursory treatment in *Aetna* might im-

\(^{116}\) *Id.* at 134, 664 S.W.2d at 466.


\(^{118}\) *Aetna*, 281 Ark. at 134, 664 S.W.2d at 466.

\(^{119}\) 264 Ark. 647, 573 S.W.2d 908 (1978).

\(^{120}\) *Id.* at 655, 573 S.W.2d at 911.

\(^{121}\) See *supra* note 93.


ply. In fact, numerous jurisdictions have accepted the idea that the statutory enactments regulating industry practices provide an exclusive remedy for carrier misconduct.\textsuperscript{124} Major portions of both sides' briefs in \textit{Aetna} were devoted to the issue.\textsuperscript{125}

\textit{Aetna} made it clear that the Arkansas court has set a high standard for proof of a prima facie bad faith cause of action. Nevertheless, the prospect of punitive damages, which is an integral part of the "new tort," gives good reason for counsel on both sides of insurance cases to be watchful. Although \textit{Aetna} sketched a broad outline, more definitive boundaries of the bad faith tort are yet to be established.

\textit{Chet Roberts}