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When insurers' litigation tactics become a liability

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Litigation is by its very nature an adversarial process. Attorneys are encouraged to be fierce advocates and zealously protect their clients' rights. For the most part, public policy has promoted this system by giving special protections to conduct in the course of litigation. The purpose of the litigation privilege is to "afford litigants and witnesses the utmost freedom of access to the courts without fear of being harassed subsequently by derivative tort actions." *Flatley v. Mauro*, 39 Cal. 4th 299, 321 (2006). But, in the context of insurance bad faith actions, the rules can change.

An insurer's litigation conduct is often perceived by the insured to be unreasonable and damaging to the insured's interests. Sometimes, this is simply a matter of perception - adverse parties rarely consider their opponent's positions reasonable or beneficial. But there are times when an insurer's conduct post-litigation can be compelling evidence of bad faith, also known as breach of the implied covenant of good faith and fair dealing. Whether an insurer's conduct during litigation can be presented as evidence of bad faith is a more complicated question.

Every California contract contains an implied covenant of good faith and fair dealing. However, in insurance contracts, unlike other contracts, breach of the implied covenant by the insurer gives rise to an independent tort known as insurance bad faith. As the state Supreme Court explained in addressing the tort of insurance bad faith, one of the reasons insurance contracts are treated differently is because "[t]he insured ... does not seek to obtain a commercial advantage by purchasing the policy - rather, he seeks protection against calamity." *Egan v. Mutual of Omaha Insurance Company*, 24 Cal. 3d 809, 819 (1979).

The state Supreme Court addressed the issue of an insurer's duty of good faith and fair dealing after litigation has been commenced in *White v. Western Title Insurance Company*, 40 Cal. 3d 870 (1985). In *White*, insureds sued a tile company for breach of contract and bad faith after it denied payment of benefits under its policies. During trial, the insureds were permitted to present post-litigation "evidence of defendant's conduct, including low settlement offers" on the cause of action for breach of the implied covenant of good faith and fair dealing.

On appeal, the insurer argued "that all evidence relating to events after plaintiffs filed suit should have been excluded on the grounds that ... the insurer stands in an adversarial position to the insured and no longer owes a duty of good faith and fair dealing." Noting that "the contractual relationship between insurer and the insured *does not terminate with commencement of litigation*," the Supreme Court rejected the insurer's argument. Stating, "a sharp distinction between conduct before and after suit was filed would be undesirable," *White* held that "defendant's proposed rule would encourage insurers to induce the early filing of suits, and to delay serious investigation and negotiation until after suit was filed when its conduct would be unencumbered by any duty to deal fairly and in good faith." It further stated that the "policy of encouraging prompt investigation and payment of insurance claims would be undermined by

defendant's proposed rule." Thus, under *White*, an insurer's litigation tactics can be evidence admissible to prove bad faith liability.

There are many factual scenarios in which post-litigation conduct may be admissible to prove insurance bad faith.

There are many factual scenarios in which post-litigation conduct may be admissible to prove insurance bad faith. For instance, often an insurer will initiate legal action against its insured to terminate, rescind or obtain a declaration of rights relating to a policy. *White* addressed such a situation, stating that an action akin to declaratory relief or "to determine whether and to what extent it must provide [policy] benefits" can give rise to bad faith liability. Indeed, *White* held that "[i]t could not reasonably be argued under such circumstances either that the insurer no longer owes any contractual duties to the insured, or that it need not perform, those duties fairly and in good faith."

Another situation where an insurer's litigation conduct can give rise to bad faith liability is where the insurer seeks to enforce its rights to subrogation through litigation. For instance, insurers have been known to occasionally file suit as plaintiff-in-intervention in actions brought by an insured against third-party tortfeasors for a loss the insurer covered. If the insurer acts unreasonably in a manner which damages the insured's third-party claim, it could give rise to bad faith liability. Indeed, *White*'s holding arguably has even greater force where an insurer seeks to protect subrogation rights as a plaintiff-in-intervention because in such a case the insurer and insured are not in an adversarial litigation posture - as they are both plaintiffs. *White* specifically held that "what constitutes good faith and fair dealing depends on the circumstances of each case, including the stage of the proceedings *and the posture of the parties*."

Although claims of post-litigation bad faith are a potentially powerful weapon in an insured's attorney's arsenal, practitioners should be aware that anti-SLAPP motions are a serious problem. The anti-SLAPP statute, enacted by the state Legislature post-*White* in 1992, allows the filing of a special motion to strike "[a] cause of action against a person arising from any act of that person in furtherance of the person's right of petition or free speech under the United States Constitution or the California Constitution in connection with a public issue ... unless the court determines that the plaintiff has established that there is a probability that the plaintiff will prevail on the claim."

Alleging post-litigation conduct as a predicate for bad faith will often satisfy the first prong of the anti-SLAPP statute, as liability is being alleged on the basis of a protected activity. This is because a protected activity includes statements in any "official proceeding authorized by law" or "made in connection with an issue under consideration or review by ... any ... official proceeding authorized by law." Once the first prong of the anti-SLAPP statute is satisfied, the burden then shifts to the insured to show a likelihood of success.

In determining the likelihood of success, the courts will consider "the pleadings, and supporting and opposing affidavits stating the facts upon which the liability or defense is based." *Equilon Enterprises v. Consumer Cause Inc.*, 29 Cal. 4th 53, 67 (2002). It also is worth noting that a plaintiff cannot avoid anÂ anti-SLAPPÂ motion by amending the complaint prior to the hearing on the motion. Thus, where an attorney alleges post-litigation conduct as a basis for bad faith liability, she or he should be prepared - from the outset of the case - to make the requisite evidentiary showing of likelihood of success on the merits.

While the anti-SLAPP statute can present an obstacle to the insured in the midst of litigation against insurance company, it can be overcome. "The critical point is whether the plaintiff's cause of action itself was based on an act in furtherance of the defendant's right of petition or free speech." *City of Cotati v. Cashman*, 29 Cal. 4th 69, 78 (2002).

Bad faith insurance litigation is notoriously hard-edged, and the potential to allege post-litigation bad faith raises the stakes. The law is clear that insurers' duties under an insurance contract do not end when litigation commences. This encourages insurers to reasonably negotiate with the insured regarding an alleged breach of contract. Counsel for insureds being confronted with bad faith litigation tactics should consider whether pursuing a claim for post-litigation bad faith under *White* would be beneficial.

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