

PUBLIC POLICY CONSIDERATIONS CONCERNING INSURANCE BAD
FAITH AND RESIDUAL MARKET MECHANISMS

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“In every insurance contract there is an implied covenant of good faith and fair dealing. The duty to so act is imminent in the contract whether the company is attending to the claims of third persons against the insured or the claims of the insured itself. Accordingly, when the insurer unreasonably and in bad faith withholds payment of the claim of its insured, it is subject to liability in tort.”¹

INTRODUCTION

In the 1997 movie *The Rainmaker*, a fictional young attorney named Rudy Baylor found himself introduced to the practice of law with a major insurance bad faith case against a fictional company named Great Benefit.² Despite inexperience and seemingly long odds, Baylor and a colleague discover the company initially had a policy of denying all initial claims and that most policyholders give up fighting their claims.³ Representing a client who died of leukemia after being denied coverage for a bone marrow transplant by Great Benefit, Baylor took his very first case to trial and won a staggering verdict of \$150,000 in actual damages for his client and \$50 million in punitive damages.⁴

Insurance bad faith not only exists in the movies but has been present in the real life courtrooms since the seminal judgment of the California Supreme Court in *Gruenberg v. Aetna Ins. Co.* in 1973.⁵ The surprising \$50 million verdict in *The Rainmaker* has even been topped in real life – for example, a 2003 bad faith case in Arizona tried to a jury resulted in an

¹ *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1038 (Cal. 1973).

² *THE RAINMAKER* (Paramount Pictures 1997).

³ *Id.*

⁴ *Id.*

⁵ *See* 510 P.2d at 1032.

approximately \$84 million award to a disabled cardiologist whose disability benefits were allegedly terminated by an insurance company in bad faith.⁶

While every jurisdiction in the United States has adopted third-party bad faith,⁷ not all jurisdictions have recognized a cause of action for first-party bad faith.⁸ Donald Wall, a noted insurance commentator, defines first-party insurance as insurance that is “obtained by the insured for its own monetary protection.”⁹ Among the jurisdictions which have adopted a cause of action for first-party insurance bad faith, some recognize it as a statutory claim based upon unfair trade practice or unfair claims settlement practices¹⁰ and others recognize it as a common law tort claim.¹¹ Allegations of insurer conduct allegedly comprising first-party insurance bad faith have been made in reported cases concerning the following insurance products – disability insurance,¹² health insurance,¹³ fire insurance,¹⁴ uninsured motorist insurance,¹⁵ title insurance,¹⁶ crop insurance,¹⁷ flood insurance,¹⁸

⁶*Ceimo v. Gen. Am. Life Ins. Co., Paul Revere Life Ins. Co. and Provident Life Ins. Co.*, AVVO, http://www.avvo.com/attorneys/98337-wa-richard-friedman-358460/legal_cases/16481 (last visited March 19, 2014).

⁷RANDY J. MANIHOFF & JEFFREY W. STEMPEL, *GENERAL LIABILITY INSURANCE COVERAGE* 532 (2d ed. 2012) (noting that “third-party bad faith arises in the context of an insured being sued by a third-party and the insured’s liability insurer takes over its defense”).

⁸*Id.* at 534.

⁹2 DENNIS J. WALL, *LITIGATION AND PREVENTION OF INSURER BAD FAITH* 2 (3d ed. 2011).

¹⁰*Id.* at 6.

¹¹MANIHOFF & STEMPEL, *supra* note 7, at 534–35.

¹²*Egan v. Mut. of Omaha Ins. Co.*, 620 P.2d 141, 146 (Cal. 1979) (holding that a disability insurer’s alleged failure to properly investigate an insured’s claim may breach the covenant of good faith and fair dealing).

¹³*Walker v. Grp. Health Servs., Inc.*, 37 P.3d 749, 757 (Okla. 2001) (holding that a state employee under Oklahoma law may sue an HMO for insurance bad faith). For more information, see Joanne B. Stern, *Bad Faith Suits Against HMOs: Finally, a Breakthrough*, 20 WHITTIER L. REV. 313, 313–14 (1998) (“Over the past forty years, many state courts have recognized that the tort of bad faith breach of contract could be brought against health insurance companies that fail to provide the insured with ‘the benefit of the bargain.’ In such cases, courts have recognized an implicit provision in every insurance contract that neither party will do anything to injure the right of the other party to receive the full benefits of the contract.”).

¹⁴*Chavers v. Nat’l Sec. Fire & Cas. Co.*, 405 So. 2d 1, 13 (Ala. 1981). For more information, see generally Cathryn M. Little, *Fighting Fire with Fire: “Reverse Bad Faith” in First-Party Litigation Involving Arson and Insurance Fraud*, 19 CAMPBELL L. REV. 43 (1996).

¹⁵*Townsend v. State Farm Mut. Auto. Ins. Co.*, 860 P.2d 236, 237 (Okla. 1993). For more information, see generally William A. Mayhew, *Bad Faith and the Uninsured Motorist Claim*, 19 FORUM 618 (1984).

and marine insurance.¹⁹ The problem of first-party bad faith in insurance has inspired a robust literature.²⁰

As insurance bad faith law has evolved, liability has not stopped with insurance companies. For example, the Supreme Court of West Virginia held that an insurance claims adjuster could be held personally liable for

¹⁶Atlantic Title Ins. Co. v. Aegis Funding Corp., 651 S.E.2d 507, 508 (Ga. Ct. App. 2007). For more information, see generally James Bruce Davis, *More Than They Bargained For: Are Title Insurance Companies Liable in Tort for Undisclosed Title Defects?*, 45 CATH. U. L. REV. 71 (1995).

¹⁷Dees v. Am. Nat'l Fire Ins. Co., 861 P.2d 141, 143 (Mont. 1993). For more information, see generally Chad G. Marzen, *Crop Insurance Bad Faith: Protection for America's Farmers*, 46 CREIGHTON L. REV. 619 (2013).

¹⁸See, e.g., Stevens v. Bankers Ins. Co., 970 F. Supp. 769, 770 (N.D. Cal. 1997) (case involving allegations of bad faith following denial of insureds' claims for business inventory loss under Standard Flood Insurance Policy).

¹⁹Powers v. United Servs. Auto. Ass'n, 962 P.2d 596, 597 (Nev. 1998). For more information, see generally Jeffery B. Struckhoff, *The Irony of Ubertimae Fidei: Bad Faith Practices in Marine Insurance*, 29 TUL. MAR. L.J. 287 (2005).

²⁰Law review articles on insurance bad faith published within the past ten years include the following: Mark J. Browne, Ellen S. Pryor, & Bob Puelz, *The Effect of Bad-Faith Laws on First-Party Insurance Claims Decisions*, 33 J. LEGAL STUD. 355, 386 (2004) (In this empirical study of insurance bad faith claims, Browne, Pryor and Puelz identified a positive correlation between higher settlement payments and the existence of the insurance bad faith remedy for policyholders); Jay M. Feinman, *The Law of Insurance Claims Practices: Beyond Bad Faith*, 47 TORT TRIAL & INS. PRAC. L.J. 693, 720 (2012) (proposing that the rule concerning insurance company's claims practices should be as follows: "the company may not act opportunistically, and it must promptly, fairly, and objectively process, investigate, evaluate, and resolve the claim"); Marc S. Mayerson, *"First Party" Insurance Bad Faith Claims: Mooring Procedure to Substance*, 38 TORT TRIAL & INS. PRAC. L.J. 861, 884-85 (2003) (contending that the genuine dispute doctrine "provides a basis for evaluating whether the policyholder's claim of unreasonable coverage denial gets to trial, and the detailed factual showing that the case law requires insurers to make on their motions for summary judgment is no more than what reasonably should be expected from insurance companies that both promise and are required to pay claims promptly unless there is proper cause not to do so"); see generally Douglas R. Richmond, *Advice of Counsel and Insurance Bad Faith*, 73 MISS. L.J. 95 (2003) (examining the insurer's affirmative defense of advice of counsel in insurance bad faith litigation); Douglas R. Richmond, *Defining and Confining Institutional Bad Faith in Insurance*, 46 TORT TRIAL & INS. PRAC. L.J. 1, 26-32 (2010) (providing recommendations for insurers to avoid situations of institutional bad faith); Jeffrey W. Stempel, *The "Other" Intermediaries: The Increasingly Anachronistic Immunity of Managing General Agents and Independent Claims Adjusters*, 15 CONN. INS. L.J. 599, 599 (2009) (proposing a standard of "intermediary liability where an intermediary is potentially liable when a policyholder has alleged negligence or some greater wrongdoing").

unfair claims settlement practices,²¹ and some courts have even examined the issue of holding an insurance defense attorney liable for bad faith.²² As bad faith liability expands, state-sponsored insurance entities may be next to incur liability.

In several coastal states, mainly in areas of a higher probability of hurricane exposure, state-run insurance entities have been established to provide property insurance coverage which is generally unavailable in the private market.²³ Given bad faith insurance liability has expanded beyond private insurers in some circumstances, can a state-sponsored property insurer operating in the residual market²⁴ incur insurance bad faith liability? The question of whether first-party insurance bad faith liability should be extended upon a state-run property insurer in the residual property insurance market is an unresolved one in many jurisdictions.²⁵ In a major 2011 decision, the Louisiana Supreme Court in *Oubre v. Louisiana Citizens Fair Plan* upheld a Louisiana trial court's award granting of a judgment in a class action case in excess of \$92 million based upon the *Citizens Fair Plan's* alleged failure to initiate timely loss adjustments on insurance claims following both Hurricanes Katrina and Rita in 2005.²⁶ Most recently, in November 2012, the Florida Supreme Court deferred a substantive ruling on the immunity issue on procedural grounds via an interlocutory appeal.²⁷

²¹Taylor v. Nationwide Mut. Ins. Co., 589 S.E.2d 55, 57 (W. Va. 2003).

²²The general doctrinal rule is that an insurance defense attorney does not directly incur insurance bad faith liability. For a more extensive discussion of this doctrinal rule, see Chad G. Marzen, *Can (and Should) an Insurance Defense Attorney Be Held Liable for Insurance Bad Faith?*, 7 VA. L. & BUS. REV. 97, 102–03 (2012).

²³Cassandra R. Cole, Patrick F. Maroney, Kathleen A. McCullough, & Charles Nyce, *The Role of State-Run Insurers in Providing Property Coverage in Coastal States with High Hurricane Exposure*, CPCU EJOURNAL, Dec. 2009, at 1, 1.

²⁴Michael A. Haskel, *Should Antitrust Principles Be Used to Assess Insurance Residual Market Mechanisms, Such as New York's Medical Malpractice Insurance Plan?*, 71 ALB. L. REV. 229, 229 (2008) (“State-created insurance residual market mechanisms are typically designed to address flaws in markets in which a significant number of purchasers have difficulty obtaining affordable insurance . . .”).

²⁵This issue has already garnered the precise attention of at least one insurance commentator. See generally Douglas Scott MacGregor, *State Sponsored Homeowner's Insurance, Bad Faith and Sovereign Immunity*, 2011 EMERGING ISSUES 5554 (LEXIS 2011).

²⁶79 So. 3d 987, 990–91 (La. 2011).

²⁷*Citizens Prop. Ins. Corp. v. San Perdido Ass'n, Inc.*, 104 So. 3d 344, 357 (Fla. 2012) [hereinafter “San Perdido III”].

In the wake of these decisions, state-run property insurers still face legal uncertainty as to their immunity from bad faith lawsuits.

This article contributes to the contemporary literature regarding bad faith in insurance by comprehensively analyzing the history of, the nature of the claims associated with, and public policies concerning the imposition of insurance bad faith liability upon state-run property insurers. Part I provides an overview of the role of residual insurance market entities of the state and federal governments and the role of state-sponsored property insurers in providing property insurance coverage to those unable to obtain coverage through the private market. Part II discusses the *Oubre v. Louisiana Citizens Fair Plan* case of the Louisiana Supreme Court and its applicability concerning the immunity issue. Part III explores the history and background of the *Citizens Property Ins. Corp. v. San Perdido Assoc., Inc.* litigation and the Florida courts' grappling of the immunity issue.

Finally, Part IV analyzes the policies and issues surrounding the holding of bad faith liability upon state-run property insurers, with a particular emphasis on the case of Florida. The first section of Part IV examines the public policy considerations of reported cases which have addressed whether a state insurance guaranty association can be held liable for insurance bad faith claims. State insurance guaranty associations provide an appropriate comparison with state-run property insurers since bad faith claims have also been proffered against them.²⁸ The second section of Part IV discusses the policy rationales behind the bad faith remedy and the specific issue of the relationship between bad faith awards and assessments which are typically levied on most insurers. Finally, examining the case of Florida in particular, this article examines the arguments concerning legislative intent on the conferral of immunity. In conclusion, weighing the relevant public policy considerations concerning insurance bad faith, this article argues that courts should not impose first-party bad faith liability on state-run property insurers who operate in the residual property insurance market.

²⁸ *Insurance Guaranty Associations: Frequently Asked Questions*, AM. COUNCIL OF LIFE INSURERS, <https://www.acli.com/Tools/Industry%20Facts/Guaranty%20Associations/Pages/FS08-007.aspx> (last visited Jan. 17, 2014).

I. THE ROLE OF INSURANCE RESIDUAL MARKETS: A HISTORIC AND CONTEMPORARY EXAMINATION

Insurance has played a significant role in the transferring and distribution of risk since the 1750s in the United States.²⁹ While Benjamin Franklin is known for many inventions, Franklin also established the colonial United States' first property insurance company.³⁰ Insurance companies are able to control, transfer and distribute specific hazards and perils in such a fashion to economically manage risk.³¹ However, in some cases, the risk of loss on a particular peril or hazard is too great to manage the risk on the private insurance market. In a number of those cases, states and the federal government have established government-run residual market mechanisms to ensure insurance is available to those who would otherwise be unable to obtain insurance on the private market. State-run insurance entities have a long history and date back to approximately a century.³²

A. *State Worker's Compensation*

At approximately the turn of the twentieth century, as Gabel notes, an increase in industrial accidents in the era of industrialization led to the enactment of legislative reforms to ensure injured workers received

²⁹ROBERT E. KEETON & ALAN J. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* 3 (practitioner's ed. 1988) ("Insurance is generally understood to be an arrangement for transferring and distributing risks.").

³⁰Brian J. Glenn, *God and the Red Umbrella: The Place of Values in the Creation of Institutions of Mutual Assistance*, 10 CONN. INS. L.J. 277, 286 n.36 (2004).

³¹KEETON & WIDISS, *supra* note 29, at 11 (stating "Risk management may be facilitated by using insurance for risk transference. For a price, usually referred to as a premium, an insured transfers to an insurer the risk of loss or the responsibility for certain costs that may arise. In addition, even though the main objective of the insurance contract is to transfer a specified loss, one incident of shifting such a risk will be that an insured will be able to avoid sustaining further losses which might result in the absence of insurance if the loss caused a forced sale of assets to meet the exigency arising from the specified loss. In other words, an insurance company is often more likely than an insured to be able to absorb the specified loss without the necessity of an uneconomical forced sale of assets.") (footnotes omitted).

³²James W. Newman, Jr., *Insurance Residual Markets: Historical and Public Policy Perspectives*, THE FLA. CATASTROPHIC STORM RISK MGMT. CTR. 1, 23 (Jul. 22, 2010) <http://www.stormrisk.org/sites/default/files/Insurance%20Residual%20Markets%20White%20Paper%20-%202017-22-10.pdf> [hereinafter "Newman"].

guaranteed compensation for their injuries.³³ State legislatures began to pass worker's compensation statutes.³⁴ In exchange for guaranteed compensation through worker's compensation insurance, an injured employee is limited to it as an exclusive remedy.³⁵ In 1917, the United States Supreme Court in *New York Cent. R.R. Co. v. White* upheld the constitutionality of the State of New York's compulsory worker's compensation statute.³⁶ Following the decision, numerous states started enacting worker's compensation laws.³⁷

Today, essentially every state has worker's compensation laws.³⁸ The vast majority of states allow private insurers to offer worker's compensation insurance to employers.³⁹ However, toward the beginning of the twentieth century several states established monopolistic state worker's compensation funds due to questions concerning the availability of reasonable premiums and to avoid the possibility of insolvencies with private insurers.⁴⁰ Today, Washington,⁴¹ Ohio,⁴² Wyoming⁴³ and North

³³ Joan T.A. Gabel, *Escalating Inefficiency in Workers' Compensation Systems: Is Federal Reform the Answer?*, 34 WAKE FOREST L. REV. 1083, 1086 (1999).

³⁴ See Note, *Exceptions to the Exclusive Remedy Requirements of Workers' Compensation Statutes*, 96 HARV. L. REV. 1641, 1641-42 (1983).

³⁵ Chad G. Marzen, *The Wrap Up of Wrap-Ups? Owner-Controlled Insurance Programs and the Exclusive Remedy Defense*, 59 DRAKE L. REV. 867, 872 (2011).

³⁶ 243 U.S. 188, 208 (1917); Gabel, *supra* note 33, at 1086-87.

³⁷ Gabel, *supra* note 33, at 1087.

³⁸ See Note, *supra* note 34, at 1642.

³⁹ Emily Richardson Roselli, Comment, *Workers' Compensation Obligations to a State Entity Under Bankruptcy Law: Which Test Should Govern How an Obligation Is Characterized for Tax Priority Purposes?*, 21 EMORY BANKR. DEV. J. 711, 716-17 (2005).

⁴⁰ NEWMAN, *supra* note 32, at 23.

⁴¹ NEWMAN, *supra* note 32, at 23. For a study which lauds the role of the Washington state worker's compensation fund in worker's compensation insurance, see J. Robert Hunter & Joanne Doroshov, *Biggest Bang For The Buck: Washington's State-Run Workers Compensation System*, AMS. FOR INS. REFORM 1, 7 (Sept. 2010), <http://www.insurance-reform.org/studies/WashingtonWCRptFCombined.pdf> (concluding "Competitive state funds deliver a bigger bang for the buck than the private sector, but Washington State's non-profit state run system significantly outperforms both. Its lower expenses and much higher allocated investment income results in a very efficient benefit delivery to employees for the lowest possible cost to employers. By insuring the entire market, the Washington Fund obtains spread of risk that is not possible for the competitive state funds, since the private market cherry-picks against the competitive funds, driving up prices and destroying the needed spread of risk. Allowing private insurers into the remarkably efficient Washington State system would surely result in greater costs for employers, smaller benefits for injured workers, and increased burdens on the state.").

Dakota⁴⁴ all operate state monopolistic funds. Thus, a private market for worker's compensation insurance does not exist in those states.

B. State Automobile Insurance Funds

Around the same time of the development of worker's compensation funds, the automobile also became widely available to the American public.⁴⁵ By the end of the 1920s the automobile reached the households of almost half of all American families.⁴⁶ However, the rise of automobile ownership also presented new risks on America's roads and highways.⁴⁷ Not all drivers who negligently caused injuries while driving an automobile had the personal financial assets capable of satisfying the injuries of plaintiffs in the tort system.⁴⁸ To help alleviate this concern, in 1927 Massachusetts became the first state in the United States to enact a compulsory insurance law.⁴⁹ While nearly thirty years passed until New

⁴²NEWMAN, *supra* note 32, at 23. For more information on the Ohio Bureau of Worker's Compensation, which administers the approximately \$28 billion state worker's compensation fund, see *BWC profile*, OHIO BUREAU OF WORKERS' COMPENSATION, <https://www.ohiobwc.com/basics/guidedtour/generalinfo/BWCProfile.asp> (last visited January 14, 2014).

⁴³NEWMAN, *supra* note 32, at 23; see *Wyo., ex rel. Wyo. Workers' Comp. Div. v. Brown*, 805 P.2d 830, 841 n.5 (Wyo. 1991) (stating "The Wyoming Worker's Compensation system is a state monopoly funded by statutorily established premium payments by employers. This is different from states where private insurance companies write worker's compensation coverage exclusively or by alternative choice. States where both a state fund and private carriers exist afford a different structure of controversy administration. Unreasonably low premium accounts for the extraordinarily hazardous occupations, such as lumbering and oil well drilling within the Wyoming change from a boom economy to a recession in industrial activities, has placed tremendous financial pressure on the underfunded Wyoming Worker's Compensation program. A comparison of the level of difference is the lumber industry where worker's compensation premiums in an adjoining state were recently about ten times higher than the amounts collected for the state fund in Wyoming.").

⁴⁴NEWMAN, *supra* note 32, at 23. For more information on the monopolistic state worker's compensation fund in North Dakota, see *History: A Brief History of Workers' Compensation in North Dakota*, NORTH DAKOTA WORKFORCE SAFETY & INSURANCE, <http://www.workforce-safety.com/about-us/history.asp#HEAD> (last visited December 5, 2013).

⁴⁵See Jonathan Simon, *Driving Governmentality: Automobile Accidents, Insurance, and the Challenge to Social Order in the Inter-War Years, 1919 to 1941*, 4 CONN. INS. L.J. 521, 524, 531 (1998).

⁴⁶*Id.* at 531.

⁴⁷See *id.* at 541-42.

⁴⁸*Id.* at 561.

⁴⁹KEETON & WIDISS, *supra* note 29, at 414.

York became the second state to adopt a compulsory insurance law in 1956,⁵⁰ today almost all states (with the exception of New Hampshire and Wisconsin) have enacted compulsory insurance legislation.⁵¹

With the advent of compulsory insurance laws, automobile insurers in many states compete with other insurers in the often profitable automobile insurance industry.⁵² Despite the general profitability of the industry, automobile insurers do not underwrite all drivers. In Maryland, a state-administered Maryland Automobile Insurance Fund operates as a residual market entity for drivers who are unable to obtain automobile liability insurance in the private market.⁵³ To obtain insurance from the Maryland Automobile Insurance Fund, a driver must either have had their annual automobile insurance cancelled or nonrenewed⁵⁴ or have been rejected for coverage by at least two insurers in the private market.⁵⁵ For otherwise uninsurable automobile risks, states generally operate “assigned risk” plans in which automobile insurers selling automobile insurance policies are required to underwrite an apportioned part of the uninsurable risks.⁵⁶

C. Federal Entities – The Federal Crop Insurance Act and the National Flood Insurance Program

The federal government also operates in the residual insurance markets in the areas of crop insurance and flood insurance. The Great Depression

⁵⁰ *Id.* at 415–16.

⁵¹ Kimberly R. Silas, *Uninsured Motorist Benefits or Workers’ Compensation Benefits? Why Choose? The Louisiana Supreme Court Has Said You Can Receive Compensation from Both: An Analysis of Bellard v. American Central Insurance Company*, 36 S.U. L. REV. 311, 313–14 (2009).

⁵² Elizabeth Bunn, *State Farm Profit Surges to \$3.2 Billion as Claims Drop*, BLOOMBERG, Mar. 1, 2013, <http://www.bloomberg.com/news/2013-03-01/state-farm-profit-surges-to-3-2-billion-as-claims-drop.html>.

⁵³ *Maryland Automobile Insurance Fund: Origin & Functions*, MARYLAND.GOV, <http://msa.maryland.gov/msa/mdmanual/25ind/html/07autof.html> (last visited Feb. 19, 2013).

⁵⁴ *Id.* (The reason can be any reason other than nonpayment of insurance premiums.).

⁵⁵ *Id.*

⁵⁶ ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, *UNDERSTANDING INSURANCE LAW* 97–98 (5th ed. 2012) (“States also regulate coverage by prescribing rules for access to insurance. For example, all states have some kind of so-called “residual market plan” through which automobile insurance is sold to people unable to obtain insurance in the voluntary market. The most common mechanism in the states is the “assigned risk” plan, under which insurers doing business in a state are required to insure some portion of otherwise uninsurable risk.”); *see also* Jennifer B. Wriggins, *Mandates, Markets, and Risk: Auto Insurance and the Affordable Care Act*, 19 CONN. INS. L.J. 275, 283 (2013).

shattered agricultural interests during the 1930s and many private insurance companies did not offer crop insurance due to the unique nature of the risks with farming.⁵⁷ In response to the devastation of the Depression, Congress enacted the Federal Crop Insurance Act in 1938, which created the Federal Crop Insurance Corporation (“FCIC”) to assist with making crop insurance widely available to farmers.⁵⁸ Prior to 1980 the FCIC solely offered and sold crop insurance policies through the program, but today eligible farmers can obtain policies not only directly through the FCIC but also through private insurers who are reinsured by the federal government through the program.⁵⁹

For years, private insurers also remained reluctant to enter into the business of writing flood insurance as insurers held the belief that the potential calamitous risk of severe flooding outweighed the benefits of any premiums that would be collected.⁶⁰ Most standard insurance policies do not cover damages resulting from floods.⁶¹ In response to the lack of affordable options for flood insurance in the private market, Congress enacted the National Flood Insurance Act in 1968 which created the National Flood Insurance Program (“NFIP”) to provide federal subsidies for flood insurance.⁶² The program is administered by the Federal Emergency Management Agency’s Mitigation Division.⁶³ Approximately 95 private insurers write policies through the NFIP and the federal government retains all risk.⁶⁴

⁵⁷Marzen, *supra* note 17, at 620–21; *see also* Fed. Crop Ins. Corp. v. Merrill, 332 U.S. 380, 383 n.1 (1947).

⁵⁸Bullinger v. Trebas, 245 F. Supp. 2d 1060, 1063 (D.N.D. 2003); Marzen, *supra* note 17, at 621.

⁵⁹Bullinger, 245 F. Supp. 2d at 1063; Marzen, *supra* note 17, at 626–27.

⁶⁰KEETON & WIDISS, *supra* note 29, at 978.

⁶¹Craig M. Collins, *Flood Insurance Is Not All Created Equal*, 74 N.D. L. REV. 35, 35 (1998).

⁶²David E. Struggess & John P. McHugh, *Flood Hazard Insurance: Requirements Imposed on Banks Extending Loans Secured by Real Property*, 16 REAL EST. L.J. 226, 227 (1988) (“The two principal objectives of the Flood Insurance Act were (1) to provide flood insurance at reasonable rates through federal subsidies and (2) to require local jurisdictions to enact land use and control measures designed to guide the rational use of flood plains as a condition for the availability of federally subsidized flood insurance.”).

⁶³Nicholas I. Kephart & Douglas J. Elliott, *National Flood Insurance Program*, CTR. ON FED. FIN. INSTITS. 1, 1 (Sept. 26, 2005), <http://www.coffi.org/pubs/Summaries/NFIP%20Summary%20revised%20Sept%2026%202005-1.pdf>.

⁶⁴*Id.* at 2 (“The NFIP retains all insurance risk. To offset this it receives premium payments, minus expense allowances (about one third of premium payments), from WYO companies. WYO

D. State-Sponsored Property Insurers

While the federal government has operated in the residual market due to the possibility of devastating natural conditions in the cases of crop insurance and flood insurance, property insurance in a number of Gulf and Atlantic states is difficult or impossible to obtain⁶⁵ due to the unique risks posed by tropical storms and hurricanes.⁶⁶ The same year as the passage of the National Flood Insurance Act, Congress also enacted the Urban Property Protection and Reinsurance Act⁶⁷ to allow states to provide insurance in response to riots in urban areas.⁶⁸ Not only did this legislation allow states to create Fair Access to Insurance Requirement (“FAIR”) plans, it essentially provided coverage for “all insurable risks.”⁶⁹ Thus, FAIR plans became the first residual market mechanisms to begin

companies also receive approximately 3.3% of the incurred loss when a claim is filed. More than 95 companies participate in this program and policies through the WYO program represent approximately 95% of total NFIP policies.”).

⁶⁵ *State-Sponsored Property Insurance Programs: A Time for Reform*, PROP. CAS. INSURERS ASS’N OF AM., 1 (Oct. 17, 2008), [http://www.pciaa.net/web/sitehome.nsf/lcpublic/513/\\$file/statecatprog-08.pdf](http://www.pciaa.net/web/sitehome.nsf/lcpublic/513/$file/statecatprog-08.pdf) [hereinafter “Property Casualty Insurers Association of America”].

⁶⁶ See Joshua Aaron Randlett, Comment, *Fair Access to Insurance Requirements: Do “Fair” Property Insurance Premiums for Individual Coastal Property Owners in Massachusetts Equate with Fairness to the Greater Market?*, 15 OCEAN & COASTAL L.J. 127, 131–32 (2010) (“In recent years, the hurricanes that have hit the United States have led to a vast amount of destruction and economic loss. In 2005 alone, hurricanes Rita, Katrina and Wilma cost an estimated \$180 billion in insurance reimbursements and federal relief. On its own, Hurricane Katrina accounted for nearly \$100 billion worth of losses and damaged approximately 300,000 homes; it was the first American natural disaster to cause such extensive destruction. In the fall of 2008, Hurricane Ike reaped devastation along the coasts of Texas and Louisiana. The financial impact to Texas was estimated by officials to be between \$27 and \$35 billion; for Louisiana, that figure rose to an estimated \$30 to \$40 billion. The staggering amount of damages can be attributed in part to the fact that there has been increased development in high-risk areas, as well as an increase in the value of the developments that are insured in such areas.”); see also Doyle Rice, *Hurricane Sandy, drought cost U.S. \$100 billion*, USA TODAY, Jan. 25, 2013, <http://www.usatoday.com/story/weather/2013/01/24/global-disaster-report-sandy-drought/1862201/> (noting that Hurricane Sandy’s estimated cost in damages to be \$65 billion).

⁶⁷ Urban Property Protection and Reinsurance Act of 1968, Pub. L. No. 90-448, 82 Stat. 555.

⁶⁸ John Hugh Gilmore, Note, *Insurance Redlining & The Fair Housing Act: The Lost Opportunity of Mackey v. Nationwide Insurance Companies*, 34 CATH. U. L. REV. 563, 579 (1985).

⁶⁹ *Id.* at 579 n.121 (citing David I. Badain, *Insurance Redlining and the Future of the Urban Core*, 16 COLUM. J.L. & SOC. PROBS. 1, 8 (1980)).

underwriting insurance risks in areas of high hurricane and tropical storm exposure.⁷⁰

Currently seven coastal states (Alabama, Florida, Louisiana, Mississippi, North Carolina, South Carolina and Texas) have some sort of state-sponsored property insurance plan.⁷¹ Of these seven states, five operate associations in which private insurers participate and property insurance on coastal risks are generally underwritten through the association. For example, Alabama's Insurance Underwriting Association provides windstorm and hail coverage to two counties located on the Gulf Coast (Baldwin and Mobile)⁷² with insurance limits of up to \$500,000 for a residential dwelling and \$1,000,000 for a commercial building.⁷³ Similarly, Mississippi's Windstorm Underwriting Association provides coverage for windstorm and hail perils along six coastal counties in southern Mississippi.⁷⁴ The states of Texas,⁷⁵ North Carolina⁷⁶ and South Carolina⁷⁷ also operate state insurance associations for coastal property insurance.

⁷⁰ *State-Sponsored Property Insurance Programs: A Time for Reform*, *supra* note 65, at 1 n.3.

⁷¹ MacGregor, *supra* note 25.

⁷² *Plan of Operation and Articles of Agreement of Alabama Insurance Underwriting Association*, ALA. INS. UNDERWRITING ASS'N 1, 1 (Aug. 1, 2011), https://aiua.org/uploads/File/AIUA%20Plan%20of%20Operation%20_08-01-2011_%20-%20Final%20-%20Approved%20by%20DOI.pdf.

⁷³ *Basic Coverage*, ALA. INS. UNDERWRITING ASS'N (2013), https://aiua.org/pages/basic_coverage ("The AIUA offers coverage on the building or structure up to a maximum of \$500,000, combined dwelling and contents, for a one to four family residential location. A total limit of \$1,000,000, combined building and contents coverage, can be written for a commercial location. A builder's risk policy will also be issued for the same limits that qualifies for the Plan. Vacant property, motor vehicles, and farm properties are ineligible for coverage.").

⁷⁴ *Mississippi Windstorm Underwriting Association (MWUA) Manual of Rules and Procedures*, MISS. WINDSTORM UNDERWRITING ASS'N, <http://www.msplans.com/MWUA/Index.htm> (last visited May 1, 2012).

⁷⁵ Texas operates the Texas Windstorm Insurance Association. See *About TWIA*, TEX. WINDSTORM INS. ASS'N, <http://www.twia.org/AboutTWIA/tabid/56/Default.aspx> (last visited Feb. 21, 2014).

⁷⁶ North Carolina actually has two insurance underwriting associations, one dealing with beach and coastal property (North Carolina Insurance Underwriting Association) and one with other residential and commercial property (North Carolina Joint Underwriting Association). For more information, see *Our Mission Statement*, NCJUA-NCIUA, <http://www.ncjua-nciua.org/html/mission.htm> (last visited Feb. 21, 2014).

⁷⁷ South Carolina operates the South Carolina Wind and Hail Underwriting Association. For more information, see *About Us*, S.C. WIND & HAIL UNDERWRITING ASS'N, <http://www.scwind.com/about.html> (last visited Feb. 21, 2014).

Similar to the underwriting associations operating in Alabama, Mississippi, North Carolina, South Carolina and Texas, the states of Louisiana and Florida both have a non-profit corporation operated by the state which provides property insurance to those unable to obtain insurance on the private market.⁷⁸ In Louisiana, Louisiana Citizens Property Insurance Corporation provides property insurance for those in Louisiana unable to procure it on the private market, but it is an insurer of last resort and its rates are mandated by law to be higher than those on the private market.⁷⁹ Similarly, in Florida, Citizens Property Insurance Corporation also serves as an insurer of last resort for those unable to obtain coverage elsewhere.⁸⁰ In the wake of tropical storms and hurricanes which have occurred in the past several years, property insurance policyholders in both states have filed claims against the entities. Both states have examined different bad faith liability issues to date, and the general question of whether a state-sponsored property insurer can be held liable for insurance bad faith is currently an unresolved one in many jurisdictions.⁸¹

II. *OUBRE V. LOUISIANA CITIZENS FAIR PLAN*: STATUTORY DAMAGES AND BAD FAITH

One of the most noticeable aspects of a claim based upon bad faith practices of an insurer is the potential for large jury verdict awards. One of the most notable cases, *Campbell v. State Farm Mutual Automobile Insurance Company*, resulted in the Utah Supreme Court upholding a Utah trial court's \$145 million insurance bad faith award resulting from alleged bad faith practices of an insurer involving a third-party liability claim.⁸² While the decision of the Utah Supreme Court was overturned by the U.S. Supreme Court in *State Farm v. Campbell* decision on due process grounds,⁸³ awards in excess of one million dollars do occur.⁸⁴ The *Oubre v.*

⁷⁸ See *Company Overview*, LA. CITIZENS PROP. INS. CORP., <http://www.lacitizens.com/CompanyOverview.aspx> (last visited Feb. 21, 2014); Paul Owers, *Citizens, Florida's Insurer of Last Resort, Can Drop You*, SUN SENTINEL (May 21, 2012), http://articles.sun-sentinel.com/2012-03-21/business/fl-citizens-cancel-20120318_1_christine-ashburn-private-insurers-state-run-insurer.

⁷⁹ *Company Overview*, *supra* note 78.

⁸⁰ Owers, *supra* note 68.

⁸¹ See MacGregor, *supra* note 25.

⁸² 65 P.3d 1134, 1141–42 (Utah 2001), *rev'd on other grounds*, 538 U.S. 408, 429 (2003).

⁸³ *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 429 (2003).

Louisiana Citizens Fair Plan decision of the Louisiana Supreme Court in 2011, did not directly involve insurance bad faith claims based upon the common law of torts or damages in the amount of \$145 million. However, the Louisiana Supreme Court's upholding of a trial court judgment in excess of \$92 million in a class action case against Louisiana's state-sponsored property insurer evokes the possibility that state-sponsored property insurers may face the payment of very large judgments.⁸⁵

A. *The Oubre Case*

August 2005 and September 2005 presented two of the largest natural weather disasters within the past decade for individuals and businesses residing within Louisiana and a large portion of the Gulf Coast.⁸⁶ On August 29, 2005, Hurricane Katrina, a Category 3 hurricane when it made landfall in southern Louisiana, produced a staggering estimated \$125 billion in economic damages,⁸⁷ taking the lives of approximately 2,000 individuals and displacing approximately 250,000 people.⁸⁸ Less than one month later, another Category 3 hurricane, Hurricane Rita, hit the Louisiana coast.⁸⁹ Hurricane Rita caused an approximately additional \$4.7 billion in damage and approximately 100 individuals were killed by the storm.⁹⁰ In the wake of both of these devastating named storms, thousands of property insurance

⁸⁴Victor E. Schwartz & Christopher E. Appel, *Common-Sense Construction of Unfair Claims Settlement Statutes: Restoring the Good Faith in Bad Faith*, 58 AM. U. L. REV. 1477, 1525 (2009) ("Expansion of bad faith has, contrary to the assertions of some legal experts over a decade ago, not reached "maturity." Multi-million dollar extra-contractual awards for bad faith are increasingly commonplace, and the state of the law reveals inconsistencies in structure, standards, and application, many of which have been aggressively targeted or manipulated to the detriment of insurers.").

⁸⁵*Oubre v. La. Citizens Fair Plan*, 79 So. 3d 987, 990 (La. 2011).

⁸⁶See *Hurricanes in History*, NATIONAL HURRICANE CENTER, <http://www.nhc.noaa.gov/outreach/history/> (last visited Feb. 21, 2014).

⁸⁷Life's Little Mysteries Staff, *How Much Did Hurricane Katrina Cost?*, LIVE SCIENCE, <http://www.livescience.com/32181-how-much-did-hurricane-katrina-cost.html> (last visited May 11, 2014).

⁸⁸Joshua Rhett Miller, *Five Years After: Hurricane Katrina Began as Unassuming Tropical Depression*, FOX NEWS, Aug. 23, 2010, <http://www.foxnews.com/scitech/2010/08/23/hurricane-katrina-began-unassuming-tropical-depression/>.

⁸⁹Mark Hancock, *Many in Louisiana, Texas Lament Rita 'Amnesia'*, USA TODAY, Jan. 25, 2006, http://usatoday30.usatoday.com/news/nation/2006-01-25-rita_x.htm.

⁹⁰*Id.*

policyholders filed property insurance claims with Louisiana Citizens Fair Plan.

In *Oubre v. Louisiana Citizens Fair Plan*, a class action lawsuit was filed on behalf of thousands of Louisiana policyholders insured with Louisiana Citizens Fair Plan (“Louisiana Citizens”) who suffered property damage during both Hurricanes Rita and Katrina.⁹¹ The plaintiffs alleged that the Louisiana Citizens Fair Plan failed to timely begin loss adjustment following the hurricanes for thousands of individual property claims in violation of Louisiana statutory law.⁹² While some states recognize bad faith claims under the common law of torts, some also recognize claims based upon unfair claims settlement practices statutes.⁹³ Louisiana’s statute concerning good faith duty and fair claims settlement practices not only explicitly provides that an insurer owes its insureds the duty of good faith and fair dealing,⁹⁴ but that in a “catastrophic loss” the insurer must initiate loss adjustment within thirty days.⁹⁵ This, allegedly, did not occur in the individual cases involved in the *Oubre* litigation. At the trial court level, the court awarded the insureds summary judgment and the statutory maximum

⁹¹ *Oubre v. La. Citizens Fair Plan*, 79 So. 3d 987, 987 (La. 2011).

⁹² *Id.* at 990.

⁹³ MANILOFF & STEMPEL, *supra* note 7, at 532–35.

⁹⁴ LA. REV. STAT. ANN. § 22:1973(A) (Supp. 2014) articulates the duty of good faith and fair dealing as follows:

An insurer, including but not limited to a foreign line and surplus line insurer, owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.

LA. REV. STAT. ANN. § 22:1973(A) (Supp. 2014).

⁹⁵ LA. REV. STAT. ANN. § 22:1892(A)(3) allows for one limited exception to the thirty day requirement. The provision states:

In the case of catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim within thirty days after notification of loss by the claimant except that the commissioner may promulgate a rule for extending the time period for initiating a loss adjustment for damages arising from a presidentially declared emergency or disaster or a gubernatorially declared emergency or disaster up to an additional thirty days. Thereafter, only one additional extension of the period of time for initiating a loss adjustment may be allowed and must be approved by the Senate Committee on Insurance and the House Committee on Insurance, voting separately.

Id. § 22:1892(A)(3).

of \$5,000 in penalties for each individual claim⁹⁶ for failure to timely begin loss adjustment, comprising a total award of \$92.865 million.⁹⁷

While the Louisiana Supreme Court in *Oubre* did not explicitly rule upon the issue of sovereign immunity of a state-run property insurer (which was not an issue raised on appeal), it addressed the key issue of whether a plaintiff needs to prove bad faith conduct prior to recovery under the statute.⁹⁸ On appeal Louisiana Citizens argued that since the unfair claims settlement practices statute explicitly articulates a duty of good faith and fair dealing,⁹⁹ then an evidentiary showing of bad faith must be proffered before recovery under the statute could occur.¹⁰⁰ The Louisiana Supreme Court rejected this argument, finding that in order to find an insurer liable for statutory failure to initiate timely loss adjustment, all the insured needed to do is to provide proof of notice of the claim and show the failure of the insurance company to timely initiate loss adjustment.¹⁰¹

Significantly, the Louisiana Supreme Court essentially adopted a *per se* approach to statutory bad faith misconduct. In essence, as a prerequisite to find a statutory violation of failure to initiate loss adjustment, no bad faith misconduct at all need be proven!¹⁰² Furthermore, Louisiana Citizens argued that their usage of “pre-printed” advance checks to policyholders for additional living expenses exculpated it from statutory liability and that the “beyond catastrophic” circumstances of the storms created obstacles to timely final adjustment of the claims.¹⁰³ However, the Supreme Court rejected this argument and stated that the “payments were based upon the *recipient’s representation* of a covered loss and conditioned upon an *eventual* evaluation of the claim,” thus the payments did not establish an initiation of adjustment.¹⁰⁴

⁹⁶ *Id.* § 22:1973(C).

⁹⁷ *Oubre*, 79 So. 3d at 990.

⁹⁸ *Id.* at 1006.

⁹⁹ LA. REV. STAT. ANN. § 22:1973(A).

¹⁰⁰ *Oubre*, 79 So. 3d at 992.

¹⁰¹ *Id.* at 999–1000.

¹⁰² *Id.* at 1000.

¹⁰³ *Id.* at 1004–05.

¹⁰⁴ *Id.* at 1005 (emphasis in original).

B. *The Implications of the Oubre Case*

Oubre establishes that a state-sponsored property insurer, or any insurer in Louisiana for that matter, may be liable for statutory violations of the duty of good faith and fair dealing without a preliminary evidentiary showing of bad faith. In June 2012, the United States Supreme Court declined to issue a *writ of certiorari* to review the decision.¹⁰⁵ Approximately one month later, in July 2012, Louisiana Citizens paid out a total of \$104 million to policyholders to cover the *Oubre* judgment.¹⁰⁶

Given the large judgment, Louisiana Citizens expressed disappointment at the Louisiana Supreme Court's ruling.¹⁰⁷ Louisiana Insurance Commissioner James Donelon, quoted in a press release following the *Oubre* decision, stated that "all property insurance policyholders in Louisiana will bear the costs of these class action lawsuits if Citizens has to implement an assessment to pay them or not."¹⁰⁸ In the wake of the decision, as well as other claims, Louisiana Citizens reported a \$119 million budget shortfall in early 2013.¹⁰⁹ It is a future possibility that the board of directors of Louisiana Citizens may charge an assessment to private insurers for each individual property policy to cover the costs of expenses related to future bad faith awards. If an assessment ever is imposed, it is possible that the costs of the assessment on the private insurers would be passed on to all policyholders in the form of higher insurance rates and premiums.¹¹⁰

While the *Oubre* decision did not directly address the immunity of a state-sponsored property insurer for insurance bad faith, its effects are potentially far reaching.¹¹¹ A key question left to be determined is whether

¹⁰⁵ Ed Anderson, *U.S. Supreme Court Refuses to Review of Appeal by Citizens Insurance*, THE TIMES-PICAYUNE, June 25, 2012, http://www.nola.com/politics/index.ssf/2012/06/us_supreme_court_rejects_revie.html.

¹⁰⁶ Associated Press, *Settlement OK'd Over Louisiana Citizens Katrina, Rita Claims*, INS. J., Feb. 1, 2013, <http://www.insurancejournal.com/news/southcentral/2013/02/01/279702.htm>.

¹⁰⁷ Press Release, La. Dep't of Ins., Donelon Disagrees with Louisiana Supreme Court Judgment Regarding Louisiana Citizens Case (Dec. 20, 2011), available at http://www.lidi.louisiana.gov/public_affairs/Press_Releases/2011_Press_Releases/12-20-11_DonelonDisagreeswithCitizensJudgment.pdf [hereinafter "Louisiana Department of Insurance"].

¹⁰⁸ *Id.*

¹⁰⁹ Associated Press, *supra* note 106.

¹¹⁰ *Id.*

¹¹¹ See Wylan Ackerman, *Insurance Bad Faith Class Action: Louisiana Supreme Court Reinstates \$92 Million Verdict*, INS. CLASS ACTIONS INSIDER (Dec. 22, 2011),

such exposure to large class action judgments can occur for state-sponsored property insurers operating outside of Louisiana. In the past several years, the Florida appellate courts have grappled with whether or not Citizens Property Insurance Corporation (“Florida Citizens”) should face liability for bad faith claims.¹¹²

III. FLORIDA CITIZENS AND INSURANCE BAD FAITH

To date, the Florida appellate courts have addressed the issue of immunity, but a definitive ruling by the Florida Supreme Court has yet to be reached.¹¹³ Most recently, in November 2012 in *Citizens Property Insurance Corporation v. San Perdido Association, Inc.*, the Florida Supreme Court declined to rule definitively on immunity on procedural grounds.¹¹⁴ With a definitive ruling on hold, and the bad faith and immunity issues remanded to the trial court, this case remains one of continuing importance not only to Florida but to the insurance industry nationally.¹¹⁵

A. *Insurance Bad Faith Law in Florida and Key Insurance Provisions*

Before any examination of the immunity of Florida Citizens for insurance bad faith can be undertaken, it is important to discuss the nature of bad faith under Florida law. The derivations of third-party bad faith claims and first-party bad faith claims differ significantly. Third-party insurance bad faith has been recognized as part of the common law in Florida since 1938.¹¹⁶ The Florida Fifth District Court of Appeal described this claim as follows:

<http://www.insuranceclassactions.com/property-insurance/insurance-bad-faith-class-action-louisiana-supreme-court-reinstates-92-million-verdict/> (“This decision should be a wake up call for the industry. These kinds of automatic statutory penalties for technical violations can potentially result in very large exposure in a class action context, as this case highlights.”).

¹¹² See, e.g., *Citizens Prop. Ins. Corp. v. San Perdido Ass’n*, 46 So. 3d 1051, 1051 (Fla. 1st Dist. Ct. App. 2010); *Citizens Prop. Ins. Corp. v. Garfinkel*, 25 So. 3d 62, 63 (Fla. 5th Dist. Ct. App. 2009); *Citizens Prop. Ins. Co. v. Bertot*, 14 So. 3d 1073, 1074 (Fla. 3d Dist. Ct. App. 2009).

¹¹³ See, e.g., *Garfinkel*, 25 So. 3d at 64.

¹¹⁴ 104 So. 3d 344, 357 (Fla. 2012).

¹¹⁵ *Id.*

¹¹⁶ See generally *Auto Mut. Indem. Co. v. Shaw*, 184 So. 852 (Fla. 1938). For an excellent discussion of the case and of Florida insurance bad faith law generally, see generally Matthew D. Schultz, Comment, *Bad Faith or No Faith? Finding a Place for Wrongful Refusal to Defend in Florida’s Bad Faith Jurisprudence*, 29 FLA. ST. U. L. REV. 1389 (2002).

The foundation for this claim is found in the fiduciary nature of the insurance carrier's relationship with the insured. The carrier was required to act in good faith to negotiate a settlement for the benefit of its insured, and not to protect its own interest alone.¹¹⁷

In comparison, the cause of action for first-party bad faith in Florida is of a statutory variety. In 1982, the Florida legislature enacted a statute which provides an insurance policyholder a cause of action against an insurer for failure to timely settle claims when the insurer "could and should have done so, had it acted fairly and honestly toward its insured and with due regard for her or his interests."¹¹⁸ Under the statute, prior to filing a first-party bad faith claim, a plaintiff is required to give a sixty-day written notice of the alleged statutory violation, giving the insurer an opportunity to resolve the claim.¹¹⁹ If the insurer does not resolve the claim within the sixty day period, then the plaintiff is enabled to file a first-party bad faith claim.¹²⁰

With regard to Florida Citizens, in its enabling statute the Florida legislature specifically granted it immunity from a wide range of claims, with a few exceptions.¹²¹ The enabling statute provides:

There shall be no liability on the part of, and no cause of action of any nature shall arise against any assessable insurer or its agents or employees, the corporation or its agents or employees, members of the board of governors or their respective designees at a board meeting, corporation committee members, or the office or its representatives, for any action taken by them in the performance of their duties or responsibilities under this subsection.¹²²

¹¹⁷ *Garfinkel*, 25 So. 3d at 68.

¹¹⁸ FLA. STAT. ANN. § 624.155(1)(b)(1) (West 2004 & Supp. 2014); *see also* FLA. S. COMM. ON JUDICIARY, INSURANCE BAD FAITH, INTERIM REPORT 2012-132, at 2 (Nov. 2011), available at <http://www.flsenate.gov/PublishedContent/Session/2012/InterimReports/2012-132ju.pdf> [hereinafter "The Florida Senate"].

¹¹⁹ FLA. STAT. ANN. § 624.155(3)(a); The Florida Senate, *supra* note 118, at 2.

¹²⁰ FLA. STAT. ANN. § 624.155(5)(d); The Florida Senate, *supra* note 118, at 2.

¹²¹ FLA. STAT. ANN. § 627.351(6)(s)(1).

¹²² *Id.*

The statute specifically lists liability for a “willful tort” as one of the exceptions to immunity.¹²³ In addition, the statute also mentions that Florida Citizens has a duty to manage its representatives and employees so that claims are carried out “carefully, timely, diligently, and in good faith.”¹²⁴

The interplay of all of these provisions has been critical to the analysis of whether or not Florida Citizens can be held liable for insurance bad faith.

B. A Florida Appellate Circuit Court Divergence

The Florida 5th District Court of Appeals first encountered the issue of Florida Citizens’ immunity from first-party bad faith claims in the *Citizens Property Ins. Corp. v. Garfinkel* decision.¹²⁵ Examining the provisions cited above from Florida Citizens’ enabling statute, the Fifth District Court of Appeals held that Citizens was immune from bad faith claims.¹²⁶ The Fifth District Court of Appeals noted that bad faith is not a “willful tort” which would fall into one of the exceptions to Florida Citizens’ immunity,¹²⁷ but rather is a statutory cause of action.¹²⁸ Furthermore, examining legislative history and citing the fact the Legislature had an opportunity to exempt bad faith claims from the immunity statute but failed to do so,¹²⁹ the Court declined to extend a sixth exception for first-party insurance bad faith.¹³⁰ Shortly following its decision in *Garfinkel*, in July 2010 the Fifth District Court of Appeals reaffirmed its holdings on immunity in *Citizens Property*

¹²³ *Id.* § 627.351(6)(s)(1)(a).

¹²⁴ *Id.* § 627.351(6)(s)(2) (“The corporation shall manage its claim employees, independent adjusters, and others who handle claims to ensure they carry out the corporation’s duty to its policyholders to handle claims carefully, timely, diligently, and in good faith, balanced against the corporation’s duty to the state to manage its assets responsibly to minimize its assessment potential.”).

¹²⁵ *Citizens Prop. Ins. Corp. v. Garfinkel*, 25 So. 3d 62, 63 (Fla. 5th Dist. Ct. App. 2009).

¹²⁶ *Id.* at 69.

¹²⁷ *Id.* at 68.

¹²⁸ *Id.* at 68–69 (“First-party bad faith causes of action now exist in Florida not because they are torts, but because they are a statutory cause of action. Accordingly, a first-party bad faith claim cannot be wedged into the statutory exception for willful torts because it is not a tort of any variety.”).

¹²⁹ *Id.* at 66.

¹³⁰ *Id.* at 65.

Insurance Corporation v. La Mer Condominium Association in a per curiam opinion.¹³¹

While the Fifth District Court of Appeals granted Florida Citizens immunity from bad faith claims, the 1st District Court of Appeals declined to address this issue in *Citizens Property Insurance Corporation v. San Perdido Association, Inc.* (“San Perdido II”).¹³² The underlying case arose out of a windstorm insurance policy damage claim by the San Perdido Association following Hurricane Ivan in 2004.¹³³ At the trial court level, the court found for the plaintiff, finding that Florida Citizens refused to fully pay the claim under its insurance policy obligations.¹³⁴ After the ruling was affirmed by the First District Court of Appeals,¹³⁵ the plaintiff filed a statutory first-party bad faith claim against Florida Citizens and Florida Citizens filed a motion to dismiss the case on the basis of immunity.¹³⁶

The First District Court of Appeals declined to address the issue on interlocutory review, holding that to conduct an interlocutory review of the motion to dismiss, a showing of irreparable harm must be made if the review is not conducted otherwise.¹³⁷ The First District Court of Appeals found that since Florida Citizens had not made a clear showing of irreparable harm, review of the immunity issue could not be made until the entry of a final judgment on the matter.¹³⁸

Most recently, in a much-anticipated judgment, in *San Perdido III* the Florida Supreme Court disapproved of the *Garfinkel* and *La Mer Condominium Association* cases, but on procedural grounds.¹³⁹ The Florida Supreme Court held that a common law writ of prohibition could not be issued for the review of an interlocutory order involving a claim of

¹³¹ *Citizens Prop. Ins. v. La Mer Condo. Ass’n, Inc.*, 37 So. 3d 988, 988 (Fla. 5th Dist. Ct. App. 2010).

¹³² *Citizens Prop. Ins. Corp. v. San Perdido Ass’n*, 46 So. 3d 1051, 1051–52 (Fla. 1st Dist. Ct. App. 2010) [hereinafter “San Perdido II”].

¹³³ *Id.* at 1052.

¹³⁴ *Id.*

¹³⁵ *Citizens Prop. Ins. Corp. v. San Perdido Ass’n, Inc.*, 22 So. 3d 71, 71 (Fla. 1st Dist. Ct. App. 2009) [hereinafter “San Perdido I”].

¹³⁶ *San Perdido II*, 46 So. 3d at 1052.

¹³⁷ *Id.* at 1053.

¹³⁸ *Id.*

¹³⁹ *Citizens Prop. Ins. Corp. v. San Perdido Ass’n, Inc.*, 104 So. 3d 344, 346 (Fla. 2012) [hereinafter “San Perdido III”].

immunity prior to a final judgment.¹⁴⁰ Thus, any judicial review of immunity of Florida Citizens for bad faith prior to final judgment cannot be reviewed until a future time, leaving the door open for other bad faith lawsuits to proceed until final resolution of this issue.

VI. PUBLIC POLICY CONSIDERATIONS CONCERNING THE IMPOSITION OF INSURANCE BAD FAITH LIABILITY UPON STATE-SPONSORED PROPERTY INSURERS

The liability of a state-sponsored property insurer for insurance bad faith brings forth many debatable questions and issues. Should state-sponsored entities operating as a residual market mechanism be liable for insurance bad faith? Will the imposition of bad faith liability upon state-sponsored property insurers do more good for claimants than harm for all property insurance policyholders collectively? The imposition of bad faith liability not only affects the policyholders and insurers which may be named plaintiffs or defendants, but potentially all policyholders in states where residual market mechanisms operate.

A. Insurance Guaranty Associations and Insurance Bad Faith

With so few reported cases to date considering issues relating to the imposition of insurance bad faith liability upon state-sponsored property insurers, courts can analogize state-sponsored property insurers to other governmental entities. At least one commentator, Douglas MacGregor, has suggested that practitioners can examine the liability of guaranty associations to analyze this issue.¹⁴¹ Insurance guaranty associations have been established in all states as state mechanisms to provide payment for covered insurance claims in the event a private insurer falls into insolvency.¹⁴² Many jurisdictions follow key provisions of the National Conference of Insurance Guaranty Funds “NCIGF Post-Assessment Property and Liability Insurance Guaranty Association Model Act.”¹⁴³ Similar to state-sponsored property insurers, the guaranty associations are

¹⁴⁰ *Id.* at 345.

¹⁴¹ MacGregor, *supra* note 25, at 17 (“In analyzing a potential bad faith action, a practitioner might look to how courts in his or her state treat the liability of guaranty associations”).

¹⁴² Susan J. Haine, *NAIC Model Act on Financial Guaranty Insurance: A Commentary*, 43 *BUS. LAW.* 717, 735 (1988).

¹⁴³ See generally NCIGF POST-ASSESSMENT PROP. AND LIAB. INS. GUAR. ASS’N MODEL ACT §§ 1–16.

funded through assessments levied on private insurers licensed to solicit business in that state.¹⁴⁴ For example, in Florida the definition of a “covered claim” is “an unpaid claim, including one of unearned premiums, which arises out of, and is within the coverage, and not in excess of, the applicable limits of an insurance policy to which this part applies, issued by an insurer, if such insurer becomes an insolvent insurer.”¹⁴⁵ It is significant to note that claims against an insurance guaranty association are limited by this statute to the limits of insurance coverage of the insolvent insurer, which would bar most claims for insurance bad faith as they are typically damages in excess of the insurance coverage policy limits available.¹⁴⁶

The Fifth District Florida Court of Appeals in the *Garfinkel* case utilized such an analysis of analogy described above.¹⁴⁷ It analogized the role of a state-sponsored property insurer (“Florida Citizens”) to that of an insurance guaranty association (“Florida Insurance Guaranty Association”).¹⁴⁸ The *Garfinkel* court noted that both Florida Citizens and the Florida Insurance Guaranty Association (“FIGA”) “fulfill the State’s public policy to make insurance available in high risk situations when private insurers are unwilling to provide such coverage.”¹⁴⁹ It also cited approvingly the Florida Third District Court of Appeals’ decision in *Fernandez v. Florida Insurance Guaranty Association, Inc.*¹⁵⁰

In *Fernandez*, a plaintiff was injured in an automobile accident caused by the alleged negligence of an individual who was insured by an insurer who became insolvent during the litigation of the case.¹⁵¹ Upon the insolvency of the private insurer, FIGA became a party-defendant to the case.¹⁵² FIGA rejected the plaintiff’s offer of settlement for the policy limits of \$10,000.¹⁵³ The plaintiff was awarded a \$54,000 verdict by the trial

¹⁴⁴ Kent M. Forney, *Insurer Insolvencies and Guaranty Associations*, 43 DRAKE L. REV. 813, 815 (1995).

¹⁴⁵ FLA. STAT. ANN. § 631.54(3) (West 2005 & Supp. 2014).

¹⁴⁶ *Id.*

¹⁴⁷ *Citizens Prop. Ins. Corp. v. Garfinkel*, 25 So. 3d 62, 67 (Fla. 5th Dist. Ct. App. 2009).

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*; *Fernandez v. Fla. Ins. Guar. Ass’n, Inc.*, 383 So. 2d 974, 974–75 (Fla. 3rd Dist. Ct. App. 1980).

¹⁵¹ *Fernandez*, 383 So. 2d at 974–75.

¹⁵² *Id.* at 975.

¹⁵³ *Id.*

court, in which FIGA was held liable for \$10,000.¹⁵⁴ After the \$10,000 award, the plaintiff then attempted to pursue a claim for the excess \$44,000 against FIGA for alleged bad faith failure to settle the claim within the policy limits.¹⁵⁵

The Florida 3rd District Court of Appeals held that no bad faith cause of action could be pursued against FIGA.¹⁵⁶ Utilizing a plain reading of the FIGA immunity statute,¹⁵⁷ the Court stated that the activities of FIGA concerning the covered claim were actions relating to FIGA's duties and thus subject to complete immunity from a bad faith claim.¹⁵⁸

The key in most cases concerning whether or not an insurance bad faith claim can be brought against an insurance guaranty association revolves around the question whether a bad faith claim is a "covered claim."¹⁵⁹ The majority of courts which have addressed the issue of whether an insurance guaranty association can be held liable for insurance bad faith, including

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* At the time of the decision in 1980, the Florida FIGA immunity statute read as follows:

There shall be no liability on the part of, and no cause of action of any nature shall arise against, any member insurer, the association or its agents or employees, the board of directors, or the department or its representatives for any action taken by them in the performance of their powers and duties under this part.

FLA. STAT. ANN. § 631.66 (West 1979), *amended by* FLA. STAT. ANN. § 631.66 (West 2005).

The statute today, Fla. Stat. § 631.66 (2003), reads almost the same as in 1980. The statute states:

There shall be no liability on the part of, and no cause of action of any nature shall arise against, any member insurer, the association or its agents or employees, the board of directors, the Chief Financial Officer, or the department or office or their representatives for any action taken by them in the performance of their powers and duties under this part.

FLA. STAT. ANN. § 631.66 (West 2005).

¹⁵⁸ FLA. STAT. ANN. § 631.66.

¹⁵⁹ *See, e.g.,* Bills v. Ariz. Prop. and Cas. Ins. Guar. Fund, 984 P.2d 574, 583 (Ariz. Ct. App. 1999); Mendes v. Haw. Ins. Guar. Ass'n, 950 P.2d 1214, 1219 (Haw. 1998); Boettcher v. Mont. Guar. Fund, 154 P.3d 629, 635 (Mont. 2007); Nev. Ins. Guar. Ass'n v. Sierra Auto Ctr., 844 P.2d 126, 128 (Nev. 1992) (per curiam); Schreffler v. Pa. Ins. Guar. Ass'n, 586 A.2d 983, 984 (Pa. Super. Ct. 1991); Hudson Envtl. Servs., Inc. v. N.J. Prop.-Liab. Ins. Guar. Ass'n, 858 A.2d 39, 46 (N.J. Super. Ct. Law Div. 2004); Vaughn v. Vaughn, 597 P.2d 932, 934 (Wash. Ct. App. 1979).

courts in Washington,¹⁶⁰ Pennsylvania,¹⁶¹ Nevada,¹⁶² Hawaii,¹⁶³ Arizona,¹⁶⁴ New Jersey,¹⁶⁵ and Montana,¹⁶⁶ have found that bad faith claims cannot be proffered. It appears that only one jurisdiction, Alaska,¹⁶⁷ has allowed bad faith claims to proceed against an insurance guaranty association. In that case, *Washington Insurance Guaranty Association v. Ramsey*, the Alaska Supreme Court, applying Washington law, held that immunity for the Washington Insurance Guaranty Association did not apply since an alleged refusal of the guaranty association to settle a claim reasonably did not fall within the association's statutory duties.¹⁶⁸ The Alaska Supreme Court reasoned that since these allegations did not fall within the duties of the association, they fell outside the scope of the immunity provision.¹⁶⁹ The *Ramsey* case is certainly distinguishable, however, by a Washington case.¹⁷⁰ It is important to note that in *Ramsey* an Alaska court interpreted Washington law.¹⁷¹ However, in *Vaughn v. Vaughn*, a Washington case interpreting Washington law, the Washington Supreme Court came to an opposite conclusion and held that bad faith claims are not "covered claims" pursuant to the Washington Insurance Guaranty Act and thus recovery for bad faith damages would not be permitted from the Washington Insurance

¹⁶⁰ *Vaughn*, 597 P.2d at 934 ("As the courts of this state have uniformly held that an action by an insured against his carrier for bad faith in handling a claim or suit sounds in tort rather than contract, . . . we must conclude that a claim for such damages is not a "covered claim" within the meaning of RCW 48.32.030(4).").

¹⁶¹ *Schreffler*, 586 A.2d at 985 (holding that the Pennsylvania Insurance Guaranty Association was immune from liability for a cause of action based upon a bad faith failure to settle a claim).

¹⁶² *Nev. Ins. Guar. Ass'n*, 844 P.2d at 128 (holding that the Nevada Insurance Guaranty Association did not owe an insured of a dissolved insurer a duty of good faith and fair dealing).

¹⁶³ *Mendes*, 950 P.2d at 1218–19 (holding the Hawaii Insurance Guaranty Association statutorily immune from liability for claims based upon bad faith).

¹⁶⁴ *Bills*, 984 P.2d at 583.

¹⁶⁵ *Hudson Env'tl. Servs., Inc. v. N.J. Prop.-Liab. Ins. Guar. Ass'n*, 858 A.2d 39, 46 (N.J. Super. Ct. Law Div. 2004).

¹⁶⁶ *Boettcher v. Mont. Guar. Fund*, 154 P.3d 629, 635 (Mont. 2007) (stating that "[i]n light of the Act's purpose to provide limited recovery, we interpret § 33–10–110, MCA, as protecting MIGA from liability arising from bad faith actions, whether grounded in tort or statutorily based, as such liability arises out of MIGA's actions in the performance of its duties to pay covered claims.").

¹⁶⁷ *Wash. Ins. Guar. Ass'n v. Ramsey*, 922 P.2d 237, 246 (Alaska 1996).

¹⁶⁸ *Id.* at 243.

¹⁶⁹ *Id.*

¹⁷⁰ *See Vaughn v. Vaughn*, 597 P.2d 932, 934 (Wash. Ct. App. 1979).

¹⁷¹ *Ramsey*, 922 P.2d at 242, n.19.

Guaranty Association.¹⁷² In addition, the Court cited the Insurance Guaranty Act which notes that in “no event shall the association be obligated to a policyholder or claimant in an amount in excess of the face amount of the policy from which the claim arises.”¹⁷³

The key underlying principle that both the *Oubre* judgment in Louisiana with Louisiana Citizens and the *Ramsey* decision in Alaska did not address is that both state-sponsored property insurers and insurance guaranty associations were established primarily as entities of last-resort.¹⁷⁴ Unlike private insurers, which are in business with an incentive for financial profit, these entities are non-profit corporations which serve to offer insurance where insurance is completely unavailable and lack a financial incentive to short-circuit policyholders and customers on insurance settlements. While private insurers may offer incentive plans to adjusters and employees through the usage of incentive plans which may link reductions in claims loss ratios to incentive income, it appears such incentives would be unavailable through a guaranty association or state-sponsored property insurer.¹⁷⁵

Furthermore, addressing governmental liability at the federal level, the Federal Tort Claims Act,¹⁷⁶ while permitting a waiver of sovereign immunity in lawsuits against the United States government in a variety of situations, also includes exceptions to liability.¹⁷⁷ One such exception to liability is the “discretionary function” exception.¹⁷⁸ The “discretionary function” exception provides that the Federal Tort Claims Act does not apply to a claim related to the federal government or an employee’s

¹⁷² *Vaughn*, 597 P.2d at 934.

¹⁷³ *Id.* The statutory provision cited in *Vaughn*, RCW § 48.32.060(1)(a)(1) is essentially identical in 2013 as it was in 1979. *See* WASH. REV. CODE ANN. § 48.32.060(1)(a)(1) (West 2010).

¹⁷⁴ *Citizens Prop. Ins. Corp. v. Garfinkel*, 25 So. 3d 62, 67 (Fla. 5th Dist. Ct. App. 2009).

¹⁷⁵ Kevin Quinley, *Slouching to Gomorrah: Adjuster Pay Plans and Bad Faith*, PROPERTY CASUALTY 360° (2006), <http://www.propertycasualty360.com/2006/01/16/slouching-to-gomorrah—adjuster-pay-plans-and-bad-faith> (stating that “some insurance companies do link adjusters’ incentive compensation to broader financial goals that the company wants to hit. In such arrangements, an adjuster’s base compensation may be fixed, but the claim person earns extra incentive income, depending on the company or claim unit’s ability to meet certain financial targets.”).

¹⁷⁶ 28 U.S.C. § 1346(b)(1) (2006).

¹⁷⁷ *See generally* David W. Fuller, *Intentional Torts and Other Exceptions to the Federal Tort Claims Act*, 8 U. ST. THOMAS L.J. 375 (2011).

¹⁷⁸ 28 U.S.C. § 2680(a) (2006).

“exercise or performance or the failure to exercise or perform a discretionary function or duty.”¹⁷⁹ A number of courts have given a broad interpretation to the “discretionary function” exception.¹⁸⁰ If the federal government is immune from suit through the “discretionary function” exception,¹⁸¹ then for purposes of reciprocal treatment state-sponsored property insurers should be permitted to exercise discretionary judgment as to the awarding of claims.

For all of the foregoing policy reasons, and given the guidance of the courts from insurance guaranty association cases, courts examining the issue of bad faith liability of a state-sponsored property insurer should not allow bad faith claims to proceed. Upon further examination of this question, both the theory behind the bad faith remedy and legislative intent considerations, particularly in the case of Florida, also support the rejection of imposing bad faith liability upon a state-sponsored property insurer.

B. California Earthquake Authority and Bad Faith Claims

Advocates of allowing bad faith damages to be imposed upon state-sponsored property insurers in future cases may cite to California’s example with the California Earthquake Authority (“CEA”).¹⁸² Just over two decades ago, on January 17, 1994, the costliest earthquake in United States history struck Northridge, California.¹⁸³ The earthquake took the lives of 57 individuals and resulted in approximately \$49 billion in losses.¹⁸⁴ As a result of the massive economic losses, numerous insurers refused to write

¹⁷⁹ *Id.*; see also Darren A. Prum & Chad G. Marzen, *Set Up for Abduction and Extortion by the IRS: Does the Reporting of Interest Paid on U.S. Bank Deposits Undermine the Government’s Obligation to Avoid Instigating Terrorism by Foreign Criminal Gangs and Drug Cartels?*, 20 TEX. HISP. J.L. & POL’Y 1 (2014); Richard Henry Seamon, *U.S. Torture as a Tort*, 37 RUTGERS L.J. 715, 737–38 (2006).

¹⁸⁰ See generally Jonathan R. Bruno, Note, *Immunity for “Discretionary” Functions: A Proposal to Amend the Federal Tort Claims Act*, 49 HARV. J. ON. LEGIS. 411 (2012) (generally discussing the jurisprudence of the United States Supreme Court which has led to a broad interpretation of the discretionary function exception).

¹⁸¹ 28 U.S.C. § 2680(a); see generally Bruno, *supra* note 180, at 411.

¹⁸² *History*, CAL. EARTHQUAKE AUTH., <http://www.earthquakeauthority.com/index.aspx?id=7&pid=1> (last visited May 11, 2014).

¹⁸³ Dana Bartholomew, *Northridge Earthquake: 1994 disaster still fresh in Los Angeles minds after 20 years*, L.A. DAILY NEWS, Jan. 11, 2014, <http://www.dailynews.com/general-news/20140111/1994-northridge-earthquake-jolt-of-a-lifetime>.

¹⁸⁴ *Id.*

new homeowner's policies in 1995 since the policies were required to include earthquake insurance.¹⁸⁵

In response to private insurers leaving the California insurance market, in 1995 the California legislature created a new basic level catastrophic earthquake insurance policy with less coverage which insurers could offer to meet the earthquake insurance policy requirement under California law.¹⁸⁶ One year later, in 1996, the CEA was established to offer the basic earthquake coverage.¹⁸⁷ The CEA is largely funded from private sources but is publicly managed.¹⁸⁸ Approximately two-thirds of insurance companies in the property insurance market in California are CEA members.¹⁸⁹

In 2000, the California legislature passed a significant piece of legislation which took effect in January of 2001 which tolled certain claims arising out of the January 1994 Northridge earthquake.¹⁹⁰ The statute revived "insurance claims "arising out of the Northridge earthquake of 1994" that previously had been barred by "the applicable statute of limitations."¹⁹¹ In *20th Century Ins. Co. v. The Sup. Ct. of Los Angeles Cnty.*, the plaintiff alleged bad faith conduct on the part of a private insurer based upon allegations that the private company did not consider damage allegedly sustained to her home during the adjustment process.¹⁹² This damage was purportedly not discovered during an adjustment of an initial claim.¹⁹³ The California Court of Appeals held that the statute applied to tort claims of insurer bad faith and noted that inclusion of such claims "furthers the legislative purpose that victims obtain damages for their

¹⁸⁵ *History*, *supra* note 182.

¹⁸⁶ *Id.* (stating "In 1995, the California Legislature created a reduced-coverage earthquake insurance policy designed to protect a policyholder's dwelling while excluding coverage for costly non-essential items such as swimming pools, patios, and detached structures. This reduced level of catastrophe coverage became known as the 'mini-policy'; insurance companies could meet the earthquake-insurance mandate by offering this no-frills, basic coverage designed to restore habitability to the structure. The intent was to enable insurers, over-exposed to catastrophic-earthquake losses, to retain more policyholders at the basic level of coverage, rather than fewer at a higher level.").

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *20th Century Ins. Co. v. The Sup. Ct. of L.A. Cnty.*, 109 Cal. Rptr. 2d 611, 615–16 (Cal. Ct. App. 2001).

¹⁹¹ *Id.*; CAL. CIV. PROC. CODE § 340.9 (West 2006).

¹⁹² *20th Century Ins. Co.*, 109 Cal. Rptr. 2d 611 at 617–18.

¹⁹³ *Id.*

insurers' misconduct."¹⁹⁴ While the case did not involve a CEA earthquake insurance policy, future courts may cite to this case as an example that the legislative intent of the California legislature is to liberally protect insureds against the bad faith conduct of private insurers concerning earthquake insurance policies.¹⁹⁵

More indicative of legislative intent in California is the actual language of the statute creating the CEA.¹⁹⁶ The California Insurance Code specifically states that the CEA can be held liable in the same manner as a private insurer as follows:

The rights, obligations, and duties owed by the authority to its insureds, beneficiaries of insureds, and applicants for insurance shall be the same as the rights, obligations, and duties owed by insurers to its insureds, beneficiaries of insureds and applicants for insurance under common law, regulations, and statutes. The authority shall be liable to its insureds, beneficiaries of insureds, and applicants for insurance as an insurer is liable to its insureds, beneficiaries of insureds, and applicants for insurance under common law, regulations, and statutes.¹⁹⁷

While advocates of extending the bad faith remedy to the actions of a state-sponsored residual market insurer may cite to this example as a public entity which can be held liable for bad faith, the CEA differs from other state-sponsored residual market insurers in one key respect. With the CEA, funds to pay out claims on earthquake insurance policies would come from not only premium dollars but assessments which are placed upon participating insurers in the CEA.¹⁹⁸ It appears such assessments would not be placed on individual policyholders in the event of a catastrophic loss as may occur in the case of *Florida Citizens*, for example.¹⁹⁹

¹⁹⁴ *Id.* at 637.

¹⁹⁵ *See id.*

¹⁹⁶ *See* CAL. INS. CODE § 10089.6 (West 2013).

¹⁹⁷ *Id.* § 10089.6(b)(2).

¹⁹⁸ *Claims Paying Capacity*, CAL. EARTHQUAKE AUTH., <http://www.earthquakeauthority.com/index.aspx?id=33&pid=1> (last visited May 11, 2014).

¹⁹⁹ *Assessments*, CITIZENS PROP. INS. CORP., <https://www.citizensfla.com/about/CitizensAssessments.cfm> (last visited May 11, 2014).

C. Other Policy Rationales Concerning Insurance Bad Faith

1. The General Polices Behind Bad Faith

There are several policies and purposes behind the general theory of insurance bad faith. A number of states, including Florida, have enacted statutory legislation providing for a first-party bad faith cause of action for the purpose of facilitating and promoting fair and prompt settlement of insurance claims.²⁰⁰ The decision of the California Supreme Court in *Gruenberg* in 1973 recognized that this duty to expeditiously settle claims does not necessarily emanate wholly from contractual obligations, but is also derived from the contractual duty of good faith and fair dealing²⁰¹ imposed by law.²⁰²

Similar to the rationale originating from the contractual duty of good faith and fair dealing, bad faith also is imposed as a means to protect the vulnerable bargaining power of the insured vis-à-vis the insurer.²⁰³ As one commentator observes, policyholders may not only be placed in a time where they are most in peril when they file an insurance claim, but are also unlikely to be able to match the litigation budgets and staffs of attorneys that many insurers have.²⁰⁴ The Kansas Supreme Court succinctly

²⁰⁰Gwynne A. Young & Johanna W. Clark, *The Good Faith, Bad Faith, and Ugly Set-Up of Insurance Claims Settlement*, 85-FLA. B.J. 9, 14 (2011).

²⁰¹JOHN D. CALAMARI & JOSEPH M. PERILLO, *CONTRACTS* 412–17 (5th ed. 2010).

²⁰²*Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032, 1037 (Cal. 1973); see also MANILOFF & STEMPEL, *supra* note 7, at 533 (which cites the passage below). The Court in *Gruenberg* stated:

In the case before us we consider the duty of an insurer to act in good faith and fairly in handling the claim of an insured, namely a duty not to withhold unreasonably payments due under a policy. These are merely two different aspects of the same duty. That responsibility is not the requirement mandated by the terms of the policy itself – to defend, settle, or pay. It is the obligation, deemed to be imposed by the law, under which the insurer must act fairly and in good faith in discharging its contractual responsibilities. Where in so doing, it fails to deal fairly and in good faith with its insured by refusing, without proper cause, to compensate its insured for a loss covered by the policy, such conduct may give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing.

Gruenberg, 510 P.2d at 1037.

²⁰³Dominick C. Capozzola, Note, *First-Party Bad Faith: The Search for a Uniform Standard of Culpability*, 52 HASTINGS L.J. 181, 188–89 (2000).

²⁰⁴*Id.*

summarized many of these arguments concerning unequal bargaining power as follows:

The cases adopting the bad faith tort generally cite the following reasons for its adoption: First, in the absence of such a tort an insurance company can arbitrarily deny coverage and delay payment of a claim with no more penalty than interest on the amount owed. . . . Secondly, since there is uneven bargaining power between an insured and its insurer, the insured needs the extra leverage the tort of bad faith would provide to even his position. . . . It has also been argued insurance contracts are contracts of adhesion Third, a bad faith cause of action is justified because of the nature of the insurance industry, which is imbued with the public interest. . . . Fourth, an insured is usually suffering from physical injury or economic loss when bargaining with the insurance company, and the vulnerable position justifies the additional remedy of a bad faith cause of action. . . . A fifth rationale is the recognition of the bad faith tort in third party situations justifies its recognition in first party situations. . . . Finally, when an insured purchases insurance, he is purchasing more than financial security; he is purchasing peace of mind. Therefore, the extra remedy of bad faith is needed to insure he receives the benefit of his bargain.²⁰⁵

Finally, Professors Tennyson and Warfel contend that insurance bad faith liability has an effect of promoting the efficiency of insurance contracting.²⁰⁶ They remarked that isolated instances of bad faith misconduct by an insurer may not result in market sanctions and the reputation penalties that would deter such conduct from occurring, as the benefits of cost savings on a claim would outweigh the market sanctions and reputation penalties potentially incurred.²⁰⁷ To counteract these

²⁰⁵ *Spencer v. Aetna Life & Cas. Ins. Co.*, 611 P.2d 149, 152 (Kan. 1980) (internal citations omitted); see also MANILOFF & STEMPEL, *supra* note 7, at 534.

²⁰⁶ Sharon Tennyson & William J. Warfel, *The Law and Economics of First-Party Insurance Bad Faith Liability*, 16 CONN. INS. L.J. 203, 217–18 (2009).

²⁰⁷ *Id.* at 218.

phenomena, they note that the potential for heavy extra-contractual liability exposure found in bad faith cases acts to deter bad faith conduct.²⁰⁸

In examining these rationales, there is a good argument that the duty of good faith and fair dealing should apply to insurance contracts issued by state-sponsored insurers just as they apply to the contracts of private insurers.²⁰⁹ But there are also a couple of significant distinctions to make. First, part of the rationale for insurance bad faith is premised upon the fact that there is an unequal bargaining power between the insurer and insured.²¹⁰ A critical difference in the case of a state-sponsored property insurer is that there is greater accountability in a sense that the state-sponsored property insurer owes greater duties to the general public as opposed to a private insurer. Although significant policies of state-sponsored property insurers typically are enacted by the board of directors,²¹¹ as a public, non-profit entity, many more activities of a state-sponsored property insurer are subject to public accountability and disclosure as opposed to private insurers.²¹² For example, some of the members of the board of directors of Florida Citizens are appointed by elected public officials.²¹³ This tends to mitigate the unequal bargaining power. Furthermore, the imposition of bad faith liability upon state-sponsored property insurers will likely not improve the insurance contracting efficiency argument

advocated by Professors Tennyson and Warfel in this particular instance. Making state-sponsored property insurers subject to bad faith liability may ultimately drive them completely out of the insurance marketplace, thus potentially resulting in a large uninsured problem where private insurers still will not take the leap to insure risks which could become catastrophic in the wake of a major tropical storm or hurricane.

²⁰⁸ *Id.* at 218–19.

²⁰⁹ *See Spencer*, 611 P.2d at 152.

²¹⁰ *Id.*

²¹¹ *Corporate Information*, CITIZENS PROP. INS. CORP., <https://www.citizensfla.com/about/generalinfo.cfm> (last visited May 11, 2014).

²¹² *See generally* OFFICE OF THE ATT'Y GEN. OF FLA., GOVERNMENT-IN-THE-SUNSHINE MANUAL (2014 ed. 2013).

²¹³ *Corporate Information*, *supra* note 211 (“The corporation is governed by a Board of Governors that administers its Plan of Operation. Florida’s Governor, President of the Florida Senate, Speaker of the Florida House and the state’s Chief Financial Officer each appoint two members to the Board.”).

2. Bad Faith and Assessments

In addition to the concerns above, making state-sponsored property insurers subject to insurance bad faith liability may have significant implications for assessments of policyholders in the private market.²¹⁴ In the case of Louisiana, as a result of the *Oubre* judgment and other bad faith lawsuits, Commissioner Donegal has noted that policyholders in Louisiana may potentially be subject to the costs of future assessments to cover the costs of the judgments.²¹⁵ In the case of Florida, which is still grappling with the issue of whether bad faith liability may be imposed on Florida Citizens, this may be a potential concern in the event it runs a deficit.²¹⁶ Under Florida law, if a deficit occurs, the first individuals who would be assessed would be Florida Citizens' policyholders through a policyholder surcharge.²¹⁷ The assessment could potentially be up to 15 percent of premium amount for each of Florida Citizens' three accounts, for a potential assessment of 45 percent.²¹⁸ If a deficit still occurred, then a regular assessment would be implemented in which policyholders from a wide range of insurance companies, not including Florida Citizens, would be assessed.²¹⁹ This assessment of up to 2 percent of premium would not only potentially affect policyholders from other property insurance companies,²²⁰ it could also be assessed on individuals with automobile insurance policies in the state of Florida.²²¹

Consider the following scenario, initially posed in a short comment by Florida Citizens in the *San Perdido III* litigation.²²² The scenario is as follows: if Florida were to be hit with a devastating hurricane or tropical storm (and everyone wishes this would never occur), but if an unfortunate event occurs and Florida Citizens' funds are depleted, then assessments

²¹⁴ See Press Release, La. Dep't of Ins., *supra* note 107; *Assessments*, *supra* note 199.

²¹⁵ Press Release, La. Dep't of Ins., *supra* note 107.

²¹⁶ *Assessments*, *supra* note 199.

²¹⁷ *Id.*

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ *Id.*

²²² This argument was initially noted briefly by Florida Citizens in the *San Perdido III* litigation. See Pet'r's Initial Br. on the Merits at 9–10, *Citizens Property Ins. Corp. v. San Perdido Assoc., Inc.*, Case No. SC10-2433 (Fla. Mar. 14, 2011) (stating “the effect of such [bad faith] suits would be to *reduce* Citizens' financial resources *for payment of policy claims* and to provide plaintiffs with additional damages at the expense of other Florida insurance policyholders”).

may be levied. And on top of this deficit, Florida Citizens may be subject to bad faith claims if the Florida courts were to allow such a cause of action to proceed. If large bad faith judgments were awarded to Citizens' policyholders, which caused a further deficit and subjected numerous individuals to a regular assessment, then the judgments may potentially be partially paid for by the automobile insurance premiums of those who may not even own a residential dwelling! Such an outcome may potentially result in a few policyholders winning very large jury verdicts in a bad faith case, with the good of a few being outweighed by the higher insurance costs of potentially many policyholders from various private insurers throughout the state of Florida. Such a result should not occur, and state-sponsored property insurers should not be subject to liability.

3. Legislative Intent and the Conferral of Immunity

Finally, arguments concerning legislative intent are significant in the analysis of whether to extend bad faith liability to state-sponsored property insurers. For instance, in the state of Florida, after the statutory provision conferring immunity for Florida Citizens there is a provision which refers to Florida Citizens having a duty "to handle claims carefully, timely, diligently, and in good faith."²²³ It was argued by the *San Perdido Association* in the *San Perdido III* litigation that to hold Florida Citizens immune from bad faith claims would render the provision essentially meaningless and the inclusion of a provision indicating an affirmative duty of good faith indicated that the legislature in Florida intended that Florida Citizens had a "duty to act in good faith, or, put negatively, prohibited Citizens from acting in bad faith."²²⁴ On the other hand, Florida Citizens has contended that legislative intent would bar any bad faith claim from proceeding against it since the Florida legislature did not explicitly include "bad faith claims" as an exception to the immunity provision.²²⁵

One of the other arguments of Florida Citizens in the *San Perdido III* litigation,²²⁶ as well as that of the decision in *Garfinkel*,²²⁷ concerned the

²²³ FLA. STAT. ANN. § 627.351(6)(s)(2) (West 2011).

²²⁴ Resp't's Answer Br. on the Merits at 22–24, *Citizens Property Ins. Corp. v. San Perdido Assoc., Inc.*, 104 So. 3d 344, 346 (Fla. 2012) (No. SC10-2433).

²²⁵ Petr's Initial Br. on the Merits at 11–12, *Citizens Property Ins. Corp. v. San Perdido Assoc., Inc.*, 104 So. 3d 344, 346 (Fla. 2012) (No. SC10-2433).

²²⁶ *Id.* at 11.

²²⁷ *Citizens Property Ins. Corp. v. Garfinkel*, 25 So. 3d 62, 66 (Fla. 5th Dist. Ct. App. 2009).

observation that the Florida legislature had the opportunity to make Florida Citizens subject to “all remedies” but the provision failed to be enacted.

Most recently, in the 2013 legislative session, the Florida legislature enacted sweeping reforms of Florida Citizens, partly as a response to alleged scandals at high levels of the corporation.²²⁸ The legislation not only provided for the creation of an “insurance clearinghouse” which is intended to move more Florida Citizens policyholders onto the private market, but creates the position of an Inspector General at the corporation and limits the maximum residential home value that can be insured by a Florida Citizens policy to \$700,000 by 2017.²²⁹ But one of the key provisions not as widely discussed was that while there was a specific attempt to explicitly state Florida Citizens could be subject to bad faith liability, that provision was not included in the final legislation.²³⁰ In the wake of *Oubre* and the *San Perdido* series of cases, the Florida Legislature thus far has appeared to reject the idea of bad faith liability for state-sponsored property insurers operating in the residual market.²³¹

For all states with state-sponsored property insurers, policymakers also have the option to take affirmative steps to ensure bad faith claims cannot be proffered against them.²³² Policymakers can adopt language similar to that utilized in the context of state insurance guaranty associations which states something to this effect: “Liability of the corporation shall not exceed the face amount of the applicable insurance policy limits in any claim filed

²²⁸Toluse Olorunnipa, *Corporate Cauldron of Misconduct Alleged at Citizens Property Insurance*, MIAMI HERALD, Nov. 20, 2012, <http://www.miamiherald.com/2012/11/20/3106943/corporate-cauldron-of-misconduct.html> (alleging that “at Citizens Property Insurance Corp., a corporate culture plagued by inter-office scandals, sexual impropriety, lavish spending, alleged cover-ups and big severance checks for disgraced employees has simmered under the radar for years”).

²²⁹Chad Hemenway, *Florida Gov. Scott Signs Bill to Reform Last-Resort Insurer*, PROPERTY CASUALTY 360°, May 30, 2013, <http://www.propertycasualty360.com/2013/05/30/florida-gov-scott-signs-bill-to-reform-last-resort>.

²³⁰2013 *Legislative Report*, CITIZENS PROPERTY INSURANCE CORPORATION 1, 3 (2013), https://www.citizensfla.com/bnc_meet/docs/515/02_2013_Legislative__Exec_Summary.pdf.

²³¹*See id.*

²³²*See, e.g.*, WASH. REV. CODE ANN. § 48.32.060 (1)(a)(1) (West 2010); *Vaughn v. Vaughn*, 597 P.2d 932, 934 (Wash. App. 1979) (holding that the language of § 48.32.060 (1)(a)(1) prevented a party from pursuing a bad faith claim against the Washington Guaranty Insurance Association).

with or against the corporation. Any damages in excess of the applicable insurance policy limits are affirmatively disallowed.”²³³

CONCLUSION

Insurance bad faith liability stands as one of the most significant doctrinal developments of the law in the twentieth century. Insurance bad faith provides a vital remedy in cases where an individual or entity not only fails to receive the contractual benefits of an insurance policy, but is also treated as if the individual or entity was not a party to the contract at all. In those types of cases, bad faith provides a remedy.

But as with many other legal doctrines, the application of insurance bad faith liability should not be absolute. Insurance bad faith should not be imposed relating to the actions of a state-sponsored property insurer. The risk of vast bad faith awards may not only realistically lead to possible bankruptcies of residual market entities, but may result in numerous innocent policyholders receiving higher insurance rates and premiums. A harm to a great many could result in exchange for the benefit of a few. A vast majority of courts have recognized this concern in refusing to extend insurance bad faith liability to guaranty associations. Insurance bad faith liability has a significant place in the law. It should certainly have a vibrant role as a safeguard of contractual rights. It just should not apply to state-sponsored entities operating as an entity of last resort in the marketplace.

²³³ See WASH. REV. CODE ANN. § 48.32.060 (1)(a)(1).