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3 Policyholder Lessons From NY Bad Faith Ruling

By **Eric Jesse and Alexander Corson** (November 14, 2024, 10:12 AM EST)

As there is not a specific formula for what constitutes insurer good faith, insurer bad faith may also take many forms. While policyholders are sometimes familiar with the quintessential bad faith fact pattern – a liability insurer's failure to settle within policy limits – the New York Appellate Division recently issued a timely reminder that an insurer's obligation to handle claims in good faith reaches far beyond the settlement context.

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As a general rule, insurance companies must place their own interests on equal footing with the interests of their insureds every step of the way. Neither a disagreement with the insured, nor the commencement of coverage litigation alters this fundamental duty of good faith and fair dealing that accompanies every insurance policy.

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An insurer that undermines this obligation with dilatory tactics designed to minimize their overall exposure can become liable for consequential damages to the insured — even exceeding policy limits.

In Rockefeller University v. Aetna Casualty & Surety Co., the university sought coverage for hundreds of sexual abuse claims brought after the New York Child Victims Act, which revived time-barred claims, was passed in 2019. Rockefeller University commenced litigation against its insurers alleging that years of obstructive and dilatory conduct breached their duty of good faith and fair dealing.

The insurers moved to dismiss and the New York Appellate Division, First Department, affirmed the denial of a motion to dismiss filed by several insurers.

On Oct. 3, the court **held** the complaint alleged viable bad faith claims predicated on: (1) "the failure to promptly resolve claims"; (2) "ignoring [the insured]'s requests for copies of decades-old policies"; (3) "failing to issue coverage decisions"; (4) "refusing to pay any settlement of the underlying claims"; (5) "refusing to properly investigate the underlying claims"; and/or (6) "pressuring [the insured] to discontinue this [coverage] action."

The court further held the insured's "complaint sufficiently alleged that defendant insurers' wait and see strategy and claims handling practices were employed to limit defendants' financial exposure, in gross disregard of [the insured]'s interests."[1]

The decision reinforces that bad faith claims handling may arise in many ways and "[t]here is no specific formula to determine whether an insurer acted in good faith." Policyholders should be aware of three principles underlying this opinion that may give rise to a bad faith claim against their insurer.

1. Failure to Settle

The most common circumstance giving rise to a bad faith claim is where the insurer will not make its policy limit available to settle an underlying case. Instead, the insurer gambles on the possibility of a lesser outcome, knowing that its potential liability will be capped at the policy limit anyway.

It is now well-settled that an insurer may not elevate its own financial interests above its insured's by withholding settlement authority needed to resolve a third-party liability. Where an insurer

unilaterally chooses to expose its insured to an excess verdict, courts hold that the insurer must satisfy the entirety of any verdict — even above the limit of liability in the policy.

Additionally, insurers must meaningfully pursue settlement opportunities and make their coverage available to resolve the claim, even in the absence of a demand within the policy limit. Particularly where an insurer is controlling the defense of a claim, policyholders should monitor the defense provided to ensure that the neither the insurer nor its appointed counsel are avoiding or "slow playing" settlement discussions to avoid receiving a demand within policy limits.

Policyholders are entitled to a vigorous defense against exposures within and above the available coverage.

2. Failure to Investigate

An insurer's duty of good faith and fair dealing also carries with it an obligation to promptly investigate and evaluate claims for coverage. As Rockefeller makes clear, insurers may not implement a "wait and see" strategy — delaying their coverage evaluation in hopes that facts may develop to support a denial of coverage.

While an insurer is entitled to receive the cooperation of its insured and may issue reasonable requests for information, an insurer may not engage in dilatory tactics by issuing endless requests for duplicative, unnecessary or publicly available information.

Particularly where an insurer has an obligation to provide a defense — which is governed by the allegations in a complaint and not by provable facts — policyholders should consider the reasonableness of serial information requests. Policyholders should also press their insurers to conduct a timely investigation while contemporaneous information is available and document the loss of available evidence through insurer inaction.

Furthermore, Rockefeller illustrates the importance of demanding that insurers search for legacy policies issued decades earlier; an insurer's duty to investigate includes a thorough and timely search for policy documentation that has been lost to time.

3. Failure to Communicate

Rockefeller also shows that an insurer's coverage investigation and evaluation is only as good as its communication to the insured. When an insurer withholds the results of its coverage investigation and evaluation to place pressure on its insured, bad faith liability can follow. Additionally, an insurer must communicate the results of its investigation in a timely manner.

Insurers that issue generic reservations of rights and do not identify possible coverage issues known from the outset of a claim may be estopped from raising those issues in a later proceeding. Policyholders should carefully consider the effect of an insurer's delay in communicating the results of its coverage evaluation when faced with a belated denial of coverage.

Conclusion

Rockefeller illustrates only a few of the scenarios that may give rise to a bad faith claim against an insurance company. Businesses facing liabilities covered or potentially covered by insurance should carefully monitor the conduct of their insurers in handling the claim — not just their stated position. While many policyholders — and insurers — assume that the contractual limit of liability in an insurance policy serves as a cap on the insurer's potential liability, that is not always the case.

In addition to becoming responsible for any excess verdict caused by the insurer's bad faith, policyholders may also recover damages flowing from the downstream consequences of an insurer's conduct, including lost opportunities where the insured had to expend its own resources to address a covered liability and damages suffered while insurance was withheld.

As in Rockefeller, insurers that elevate their interests above that of their insureds may find themselves exposed to bad faith liability far exceeding the promised coverage they sought to avoid.

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[1] Rockefeller University v. Aetna Casualty & Surety Co. , 217 N.Y.S.3d 562, 563 (App. Div. 2024).

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