

Bad Faith

By Lloyd Rain, December, 2002; Re-edited for web posting February, 2011

Introduction

I've never really thought much about bad faith. In fact, I like to think that I've lived most of my life in good faith, all of my relationships and transactions being honest and trustworthy (although at the same time I know I've slipped into pettiness or grandiloquence at the expense of others at times).

For me, bad faith has been a remote and elusive concept. Probably the first time I ran across it was in John Grisham's book, "The Rainmaker," in which an insurance company is found guilty of egregious claim denials resulting in a young man's death. But for me, it was definitely not one of those issues on the cutting edge of legal theory. Now, somewhat to my surprise, bad faith is exactly that.

Bad Faith — As best It Can Be Defined

Bad faith is not a simple issue to define, especially because it is generally a civil issue and differs from state to state. The definitions in each state evolve from the body of case law which can be likened to the collective legal memory of all past adjudications.

One of the broadest definitions comes from Massachusetts' General Law Chapter 93A, known officially as the Consumer Protection Law and unofficially as the "lemon law." It simply defines any business practice that is deceptive or unfair as culpable.

Opposite Massachusetts, is the Wisconsin definition from its Statute 943.20(b) which states, in part, "{Anyone} having possession or custody of money who intentionally uses, transfers, conceals, or retains possession of such money without the owner's consent, contrary to his or her authority...or ... a refusal to deliver any money which is in his or her possession as trustee upon demand of the person entitled to receive it, is prima facie evidence of intent to convert to his or her own use within the meaning of this paragraph." In Wisconsin, a person may bring a civil action against the perpetrator regardless of whether there has been a criminal action. If the plaintiff prevails, he or she may recover triple damages plus all costs of the litigation.

The Supreme Court of Canada has provided, perhaps, the most precise and damning definition of bad faith, not as a statute, but as judicial rendering in the case of *Vorvis versus The Insurance Company of British Columbia*. In that ruling, the court stated that "punitive awards come into play when there has been conduct that is malicious, high-handed, arbitrary, deliberate or vicious."

As you can see, "bad faith" eludes a universal, clear, legal definition. Some of the cases themselves provide the reduction to reality.

Three cases, only one of which I will examine in detail, demonstrate the issue of bad faith with striking clarity.

Case One: Tri-Tech Corp of America versus Americomp

The Frantz Group contracted with Americomp Services, Inc. for installation of a computer network. Americomp, in turn, retained Tri-Tech Corporation to lay the cable in the building. Tri-Tech completed the work without incident and Frantz paid Americomp \$27,807 for that work.

For some unknown reason, Americomp did not pay its sub-contractor, Tri-Tech. After repeated requests and invoices, including several court appearances, Tri-Tech sued Americomp, complaining that the failure to pay was a violation of Wisconsin's "theft by contractor law" and a misappropriation of trust funds. Tri-Tech sought treble damages as well as costs and attorney fees. The trial court ruled for Tri-Tech.

Americomp appealed, but the appellate court said that the evidence established that Americomp knew that it had the money in a trust, knew that it had a fiduciary duty to pay Tri-Tech, and misappropriated those funds. The court said that Tri-Tech was entitled to treble damages plus fees and affirmed the trial court decision. In doing so, the court said that "...if a contractor is building several houses and uses a progress payment on the most recent one to pay off the subs on a previous one, that is larceny." Here there was an intent to defraud, i.e., "to use the money held in trust for purposes other than to pay the people who did the work for which the money was held in trust." That is fiduciary bad faith. Thus, the original debt of \$27,807 turned into a judgement of well over \$100,000. {1}

Case Two: Whitten versus Pilot Insurance Company

The flames raced through Keith and Daphne Whiten's rural Ontario, Canada home with astounding speed. Panic-stricken and clad only in night clothes on a minus-18-degree night, they could only watch as everything they owned was consumed. It would normally have been an uncontested insurance settlement — sift through the ashes; assess the traumatized survivors; settle up.

Instead, Pilot Insurance Company proceeded to evolve an arson charge against the Whitens and denied the claim. When one of its own adjusters recommended that Pilot make good on the claim, the insurer promptly replaced him. The company ignored the conclusions of a fire chief, an engineer and the Insurance Crime Prevention Bureau. It deliberately withheld information from the defense and continued to believe the worst of the Whitens, despite there being a good explanation for virtually every seemingly suspicious circumstance in the case.

Small wonder then, that on January 25, 1996, the jury whacked Pilot with a \$1,000,000 award, over three times the replacement cost of the house, for punitive damages for acting in extreme bad faith.

In a similar case one Canadian Justice emphasized that "...punitive damage awards must both reflect the degree of reprehensibility of the perpetrator's conduct and eliminate any profitability that may have resulted."

Case Three: J&S Insulation versus United States Fidelity & Guaranty Company (henceforth "USF&G")

{Please note that, as is my habit, I have greatly simplified this case in order to make the salient points clear. The reader is encouraged to read the case memorandum in its entirety and will find numerous references to it on the web.}

R.W. Granger & Sons, Inc. ("Granger") was the general contractor on construction work at Logan Airport, Boston. J&S Insulation was one of its subcontractors; USF&G was the surety for performance and payments bonds.

A dispute arose between Grainger and J&S. Grainger withheld payments from J&S on several occasions, finally completing the job roughly \$200,000 in arrears with J&S.

J&S sued both Grainger and USF&G for the balance.

On October 26, 1994, a jury returned a \$203,867 verdict against Granger in favor of J&S. Some ten months later, on September 6, 1995, a judgment was entered against Granger in the amount of \$307,527, the amount of the original verdict with interest and costs. That same day, a judgment was entered in favor of J&S against USF&G as surety in the amount of \$410,245, the amount of the verdict, interest, and statutory attorney's fees. Thus, because Granger declined to pay the first judgement, USF&G became liable for over \$400,000 to J&S on a claim which was originally just over \$200,000.

The day after the hearing on the payment bond, USF&G offered to settle all of J&S's claims for \$230,000. J&S rejected the offer. USF&G, in spite of repeated requests from J&S for payment of the complete \$410,245 judgement, refused to communicate with J&S and made no attempt to resolve the judgement. Thus, J&S had to sue again in order to collect its money.

The case eventually wound up in the Massachusetts Supreme Court and was heard on May 10, 2001.

The judges came down hard on USF&G, harder than expected, but not as hard as they could have. In effect, the court confirmed the award of double damages when it could have applied triple damages had it desired to do so.

The punitive damages were awarded after a lower court judge concluded that USF&G had **wilfully and knowingly** violated General Law 93A (Consumer Protection "bad faith" Law) in withholding payment on a payment bond.

The lower court judge stated that USF&G's "inexplicably tardy" and inadequate offer, and other "cavalier" post verdict conduct, constituted violations of several provisions of Massachusetts "bad faith" laws. He found that "USF&G had failed to conduct "a reasonable investigation" of Granger's dispute with J&S both prior to and after the jury verdict; failed to exercise its duty to "affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed; and failed to effectuate "prompt, fair and equitable settlements of claims in which liability has become reasonably clear." Additionally, the judge found that USF&G had violated General Law 176, which prohibits an insurer from forcing an insured "to initiate litigation to recover amounts due..." by offering substantially less than the amounts ordered by the court and thus, compelled J&S to pursue litigation.

The judge further found that USF&G's presentation to J&S of "a manifestly inadequate offer of settlement" had compelled J&S to "re-commence litigation" in February, 1995, and that its March 9, 1995, answer to J&S's claim was "an insincere response calculated solely to avoid the inevitable day of reckoning." The totality of this conduct, the judge concluded, amounted to **"willful and knowing unfair and deceptive acts and practices."**

At the conclusion of the trial, the judge ordered USF&G to pay J&S double damages in the amount of \$820,491 (representing double the amount of the underlying judgment against USF&G), together with the original judgement of \$410,245 and interest on same from February 21, 1995.

Assuming interest at 5% over six years, USF&G had managed to get itself into the soup for a whopping \$1,370,258 when it could have walked away with a payment of \$203,867 in October of 1994!

Comments

Perhaps USF&G's attorneys needed to be reminded of the First Rule of Holes, "When you're in one, quite diggin'."

Now, it should be clear that the legal concept of bad faith is not one to be relegated to the back row of legal boredom. In fact, Canada, a nation which has consistently viewed our punitive awards with horror, is now, good or bad, catching up to us.

Here's what Kirk Makin of the Toronto Globe and Mail newspaper had to say, "As courts question the cost of bad faith awards, Canada may be moving toward the US-style punitive damage awards. One justice said, '...punitive damages must be so painful that no like-minded scoundrel could mistake them for a license to do business in such a manner.' (Justice Laskin of the Ontario Supreme Court)."

In the United States, bad-faith findings against insurers have become so prevalent, and have proven so lucrative to plaintiffs, that a thriving web site lists the best and worst insurance companies and provides reams of commentary.

For a real eye-opener spend a few minutes at <http://www.badfaithinsurance.com>. For example, this is what the site had to say about the insurance company I've been with for over thirty years.

Very bad record for the largest and most powerful U.S. insurer — bad faith insurance claim practices, non-payments of claims, an enormous number of complaints and claimants' lawsuits, many with appalling stories of foul play and consumers being victimized ... Numerous, widespread and repeated examples of bad faith and abusive practices inflicted nationwide upon consumers, claimants and their own policyholders.

Final Observation

The net of all this is that the courts are seeing more and more bad faith cases as business increases not only in competitiveness, but in complexity. Because of these factors, an increasing number of

resources are being placed into the care and custody of others — others who may or may not always act in good faith as they carry out their fiduciary duties and obligations.

Whenever a fiduciary responsibility, whether written or implied, is carried out in a manner that is inconsiderate of the respondent, and possibly laden with malicious intent, the reward for such ignominious behavior will be increasingly harsh and costly penalties.

I am reminded of a phrase coined by one of my indomitable English professors some 40 years ago. When confronted with a fiduciary lapse, he said to the perpetrator, “I shall descend upon you like a bolt of greased lightning and cleave you from stem to gudgeon.” That statement well characterizes the current attitude of the courts when called upon to rule on bad faith business practices.

•————— End —————•

{1} Tri-Tech Corp. of America V. Americomp, Court of Appeals of Wisconsin, July 18, 2001

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