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INSURANCE BAD FAITH INSTRUCTIONS

Introduction

These instructions have been extensively revised and reorganized from the prior RAJI (CIVIL) 5th Bad Faith Instructions (July 2013), which were not materially changed from those in RAJI (CIVIL) 4th.

Intended Use of Instructions. These instructions are intended for use only in actions against insurance companies for breach of the covenant of good faith and fair dealing implied by law in the insurance contract. They may require modification for certain related contexts, such as suits against sureties on performance bonds, which are treated as insurance bad faith.[1] In noninsurance cases involving breach of the implied duty of good faith and fair dealing, other instructions should be used. *See, e.g.*, RAJI (CIVIL) 5th Contract 16 ("Good Faith and Fair Dealing"); RAJI (CIVIL) 5th Employment Law 2-3 ("Implied and Express Contracts (Good Faith and Fair Dealing)" and "Breach of an Implied Contract"). If the case also, or only, involves a claim for breach of the insurance contract, the RAJI (CIVIL) 5th Contract Instructions should be used for that contract claim, with such modifications or additions as may be appropriate for insurance-specific contract principles, such as the burdens of proof for coverage and exclusions from coverage.

Nature of Duty in Insurance Cases. The Arizona Supreme Court has recognized that while a covenant of good faith and fair dealing is implied in every contract, and the remedy for breach of the implied covenant is ordinarily on the contract itself, "in special contractual relationships, when one party intentionally breaches the implied covenant of good faith and fair dealing, and when contract remedies serve only to encourage such conduct, it is appropriate to permit the damaged party to maintain an action in tort and to recover tort damages." *Rawlings v. Apodaca*, 151 Ariz. 149, 158-61 (1986). The Court reasoned that tort remedies, including compensatory damages for emotional distress and punitive damages, should be available in the insurance setting because "in buying insurance an insured usually does not seek to realize a commercial advantage but, instead, seeks protection and security from economic catastrophe." *Id.* at 154. Thus, "one of the benefits that flow from the insurance contract is the insured's expectation that his insurance company will not wrongfully deprive him of the very security for which he bargained or expose him to the catastrophe from which he sought protection." *Id.* at 155. In such "special, partly noncommercial relationships," where the insurance covers the insured's liability to another, "the insured surrenders to the insurer the right to control and manage the defense of claims made against him"; where the insurance covers the insured's own personal losses, "the insurer sets the conditions for both presentment and payment of claims." *Id.* at 154. "In both … situations the contract and

[1] *See Dodge v. Fid. & Deposit Co. of Md.*, 161 Ariz. 344, 346-48 (1989) (treating sureties providing construction performance bonds as insurers and recognizing that same duty of good faith applies to an obligee's claim that the principal has defaulted).

the nature of the relationship effectively give the insurer an almost adjudicatory responsibility." *Id.* The Supreme Court also reasoned that in such settings, "contract damages not only fail to provide adequate compensation but also fail to provide a substantial deterrence against breach by the party who derives a commercial benefit from the relationship." *Id.* at 159.

Insurance Policy and Statutes. In some areas, the provisions of the insurance policy are dictated by statute; indeed, some policies may expressly invoke the pertinent statute to describe the coverage and benefits available. Examples of such areas include worker's compensation coverage; fire insurance under the New York standard fire policy, edition of 1943, A.R.S. § 20-1053; and certain aspects of motor-vehicle liability coverage, A.R.S. § 28-4009. While those insurance statutes may not directly dictate the scope of bad-faith liability under Arizona, they may inform the parties' respective obligations under the insurance policy. The Insurance Bad Faith Instructions do not attempt to cover such statutory issues. The trial court may need to additional instructions on such statutory provisions and legal issues if warranted by the facts and issues in the case. *See* Insurance Bad Faith 3, 8, 9A, 9B.

First-Party and Third-Party Bad Faith. The Insurance Bad Faith Instructions are divided into two groups that reflect the two basic types of bad-faith actions: First-Party Bad Faith (Insurance Bad Faith 1-6) and Third-Party Bad Faith (Insurance Bad Faith 7-13). Unlike some other states, Arizona courts recognize a tort claim for both types of bad faith. *See Noble v. Nat'l Am. Life Ins. Co.*, 128 Ariz. 188, 189-90 (1981) (recognizing first-party bad faith); *Farmers Ins. Exch. v. Henderson*, 82 Ariz. 335, 338 (1957) (recognizing third-party bad faith). In this context, these terms refer to the nature of the underlying insurance coverage. As the Arizona Supreme Court explained this distinction, "[f]irst-party coverage arises when the insurer contracts to pay benefits directly to the insured," while "third-party coverage arises when the insurer contracts to indemnify the insured against liability to third parties." *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256, 258 (1990). First-party coverages include health insurance, life insurance, disability insurance, homeowner's fire insurance, uninsured- and underinsured-motorist coverages, and automobile property-damage coverage, while third-party coverages include commercial general liability (CGL) policies and automobile liability coverages. *See id.*

Although the terms "first-party" and "third-party" refer to the nature of the coverage, they are at times also used somewhat confusingly to refer to the party that brought the bad-faith claim, i.e., whether the claim was brought by an insured (a first-party claim) or a tort claimant injured by an insured tortfeasor (a third-party claim). For example, in *Rawlings v. Apodaca*, the Arizona Supreme Court commented that "[c]laims brought directly against an insurer by its own insured are commonly referred to as 'first-party' claims, while those brought against the insured by a third person are called 'third-party' claims." 151 Ariz. at 153 n.2; *cf. Leal v. Allstate Ins. Co.,* 199 Ariz. 250, 254, ¶ 21 (App. 2000) (holding that "a third-party claimant, a stranger to the contract, cannot sue the insurer for tortious breach of the duty of good faith"). In *Clearwater v. State Farm*, however, the Supreme Court recognized that, in light of the assignability of bad-faith claims, "[t]he type of claim is not determined by the identity of the party bringing the bad faith action against the insured." 164 Ariz. at 258. The Court explained, "For

example, a third-party action might be brought by the insured in the event that he is subjected to excess liability by reason of the insurer's bad faith refusal to settle. In that event, the standards applicable to third-party claims would govern the action, although it was brought by the insured, rather than a third-party assignee." *Id.*

It is conceivable that first- and third-party claims could be asserted in the same action, but that would be an unusual situation involving the allegedly improper handling of claims under separate coverages, e.g., a claim that the insurer mishandled a claim for first-party medical-payment or property-damage benefits for an insured party, and also unreasonably failed to defend or settle a tort victim's claim against the insured. As a result, the lawsuit will almost always call for using either the First-Party or Third-Party Bad Faith Instructions, but not both.

Insured's Duty of Good Faith and Fair Dealing. The duty of good faith and fair dealing applies to both the insurer and the insured. *Rawlings v. Apodaca*, 151 Ariz. at 153. Arizona courts have not yet defined the legal consequences of an insured's breach of the duty of good faith and fair dealing. Accordingly, the Committee has not attempted to draft any instructions regarding these issues.

INSURANCE BAD FAITH 1

First-Party Bad Faith:
Duty of Good Faith and Fair Dealing

[*Name of plaintiff*] claims that [*name of defendant*] breached its duty of good faith and fair dealing. ~~Under an insurance policy, a~~An insurance company has a duty to act fairly and in good faith. ~~This duty is implied by law and need not be in writing.~~ The duty of good faith and fair dealing requires an insurance company to give as much consideration to an insured's interests as it gives to its own interests when it is investigating, evaluating, and processing the insured's claim.

SOURCE: *Deese v. State Farm Mut. Auto. Ins. Co.*, 172 Ariz. 504, 507 (1992); *Rawlings v. Apodaca*, 151 Ariz. 149, 157 (1986); *Noble v. Nat'l Life Ins. Co.*, 128 Ariz. 188, 190 (1981).

INSURANCE BAD FAITH 2

First-Party Bad Faith: Elements

On the claim for breach of the duty of good faith and fair dealing, [*name of plaintiff*] must prove:

1. [*Name of defendant*] breached the duty of good faith and fair dealing;
2. [*Name of defendant*]'s breach was a cause of [*name of plaintiff*]'s damages; and
3. The amount of [*name of plaintiff*]'s damages.

SOURCE: *Rawlings v. Apodaca*, 151 Ariz. 149, 153 (1986).

INSURANCE BAD FAITH 3

First-Party Bad Faith: Standard for Breach of Duty

To prove that [*name of defendant*] breached the duty of good faith and fair dealing, [*name of plaintiff*] must prove:

1. [*Name of defendant*] [*describe challenged action*] without a reasonable basis for that action; and

2. [*Name of defendant*] either knew that it had no reasonable basis for that action or was reckless in determining whether it had a reasonable basis for that action.

   [a. An insurance company is reckless if it is aware that its investigation or evaluation was inadequate or incomplete.]

   [b. An insurance company is reckless if it fails to perform an investigation or evaluation adequate to determine whether it has a reasonable basis for that action.]

SOURCE: *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234, 238, ¶ 22 (2000); *Deese v. State Farm Mut. Auto. Ins. Co.*, 172 Ariz. 504, 507 (1992); *Rawlings v. Apodaca*, 151 Ariz. 149, 157, 160 (1986); *Noble v. Nat'l Am. Life Ins. Co.*, 128 Ariz. 188, 190 (1981); *Cavallo v. Phoenix Health Plans, Inc.*, 250 Ariz. 525, 530, ¶ 15 (App. 2021); *Twin City Fire Ins. Co. v. Leija*, 243 Ariz. 175, 182, ¶ 27 (App. 2017); *Sobieski v. Am. Standard Ins. Co. of Wis.*, 240 Ariz. 531, 534, ¶ 11 (App. 2016); *Nardelli v. Metro. Grp. Prop. & Cas. Ins. Co.*, 230 Ariz. 592, 597-98, ¶ 19 (App. 2012).

USE NOTES:

1. Description of Challenged Action: The instruction should describe the category of conduct that the plaintiff alleges constituted bad faith, such as "denied the claim," "failed to pay the claim," "failed to properly investigate the claim," "delayed payment of the claim," or some other action that may not involve payment of claims, such as actions that were deceitful or designed to obfuscate the facts.

2. Recklessness: In addition to paragraphs (1) and (2), the court should give paragraphs (a) and/or (b), depending on the theories and evidence at trial.

COMMENTS: 1. Fair Debatability: Some cases discussing first-party bad faith use the term "fairly debatable." *See Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234, 237 (2000); *Lennar Corp. v. Transamerica Ins. Co.*, 227 Ariz. 238, 244-45 (App. 2011). Although the Arizona Supreme Court has indicated that this concept is appropriate for an instruction in a first-party bad faith case, the court has also held that the failure to give an instruction containing the phrase "fairly debatable" in a first-party bad faith case is not error. *Compare Clearwater v. State Farm Mut. Auto. Ins. Co.*, 164 Ariz. 256 (1990), *with Sparks v. Republic Nat'l Life Ins. Co.*, 132 Ariz. 529, 538 (1982). The Committee decided not to include the words "fairly debatable" in these instructions, reasoning that the phrase was susceptible to misconstruction, and the concept was adequately and more clearly covered by the "reasonable basis" language.

INSURANCE BAD FAITH 4

First-Party Bad Faith: Intentional Conduct

To prove that [*name of defendant*] breached its duty of good faith and fair dealing, [*name of plaintiff*] must prove that [*name of defendant*] intended its conduct, but [*name of plaintiff*] does not need to prove that [*name of defendant*] intended to cause injury. [*Name of defendant*]'s conduct is not intentional if it is inadvertent or due to a good-faith mistake.

SOURCE: *Zilisch v. State Farm Mut. Auto. Ins. Co.*, 196 Ariz. 234 (2000); *Rawlings v. Apodaca*, 151 Ariz. 149, 160 (1986); *Rowland v. Great States Ins. Co.*, 199 Ariz. 577 (App. 2001); *Deese v. State Farm Mut. Auto. Ins. Co.*, 168 Ariz. 337 (App. 1991).

USE NOTE: In *Rawlings v. Apodaca*, the Arizona Supreme Court defined the intent requirement in first-party bad faith cases as "the intent to do the act." 151 Ariz. at 160. This was distinguished from "inadvertence, loss of papers, misfiling of documents and like mischance." *Id.* at n.5. In many or even most cases, the element of intentionality will not be an issue because the insurance company does not contend that its conduct was inadvertent or otherwise unintentional. In those cases, this instruction should not be given.

INSURANCE BAD FAITH 5

First-Party Bad Faith: Causation

A breach of the duty of good faith and fair dealing is a cause of damages if it helps produce the damages, and if the damages would not have occurred without the breach.

SOURCE: RAJI (CIVIL) 5th Fault 2; *Schwartz v. Farmers Ins. Co. of Ariz*, 166 Ariz. 33, 36-3 (App. 1990) (finding no error in giving causation instruction).

INSURANCE BAD FAITH 6

First-Party Bad Faith: Measure of Damages

If you find that [*name of defendant*] is liable to [*name of plaintiff*] for breach of the duty of good faith and fair dealing, you must then decide the full amount of money that will reasonably and fairly compensate [*name of plaintiff*] for each of the following elements of damage proved by the evidence to have been caused by [*name of defendant*]'s breach:

1. The unpaid benefits of the policy;
2. Attorneys' fees and litigation expenses reasonably incurred by [*name of plaintiff*] to obtain the benefits of the insurance policy;
3. Monetary loss or damage to credit reputation experienced and reasonably probable to be experienced in the future; and
4. Emotional distress, humiliation, inconvenience, and anxiety experienced, and reasonably probable to be experienced in the future.

SOURCE: *Rawlings v. Apodaca*, 151 Ariz. 149, 153 (1986); *Farr v. Transamerica Occidental Life Ins. Co.*, 145 Ariz. 1, 7 (App. 1984); *Schwartz v. Farmers Ins. Co. of Ariz.*, 166 Ariz. 33, 35-36 (App. 1990).

USE NOTE: **1. Elements of Damages:** The jury should be instructed only on those elements of damages for which there is proof. If the plaintiff has suffered physical injury as a result of defendant's bad faith, consider using an appropriately modified version of RAJI (CIVIL) 5th Personal Injury Damages 1.

2. Attorneys' Fees. This instruction concerns the jury's award of attorney's fees and litigation expenses as tort damages, rather than the court's award of attorney's fees as fees under A.R.S. § 12-341.01(A) or another fee-shifting statute, or the court's award of taxable costs under A.R.S. § 12-331. Certain categories of fees and expenses may be recoverable by either means, but some may not. *See, e.g.*, *Schwartz v. Farmers Ins. Co. of Ariz.*, 166 Ariz. 33, 35-36 (App. 1990) (attorney's fees recoverable as tort damages are limited to those incurred to pursue the contract claim and may not include any fees or costs incurred in bad-faith claim).

3. Prejudgment Interest: Plaintiff may be entitled to prejudgment interest on liquidated elements of damages, including unpaid benefits under the policy. The computation of prejudgment interest is not ordinarily submitted to the jury. If there is no dispute about the amount of unpaid benefits, the court can, after the verdict, calculate prejudgment interest as a matter of law at the legal rate under A.R.S. § 44-1201(A)-(B) and (F) and include it in the judgment. *See* A.R.S. § 20-462(A) (providing for award of interest at the legal rate on first-party insurance benefits that are not paid within thirty days after the

insurer receives an acceptable proof of loss); *N. Ariz. Gas Serv. v. Petrolane Transp., Inc.*, 145 Ariz. 467, 479 (App. 1984) (interest on liquidated claim). If there is a dispute about the amount of the unpaid benefits, special interrogatories to the jury may be necessary.