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Insurance Bad Faith

The Troubles Of *Trafalgar*: Bad Faith In the Absence Of Breach Of Contract

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Commentary

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How can a first-party insurer be legally liable for insurance "bad faith" if it has already been found *not* to be liable for breach of the insurance contract? According to at least one Florida appellate court, by paying an Appraisal Award timely.

I. Twelve Years Ago

Twelve years ago we warned of the problems the courts were creating with the appraisal provision in a property insurance contract, especially in Florida. We wrote:

> **The Gathering Storm**
> For over one hundred years the appraisal clause has been efficiently resolving disputes between insured and insurer over the amount of the claim. There is, however, a disconcerting trend of invoking appraisal in an attempt to circumvent the terms and conditions of the insurance contract, conceal fraud, and "create" evidence of "bad faith." This paper warns of the calamity and complexities that will occur if this issue is not properly addressed by insurers, insureds, and the courts.

* * *

Traditionally, the process is as follows. The insured appoints *as its* appraiser, the insured's own public adjuster, contractor, or estimator. The insurer, in turn, appoints *its* own independent adjuster, contractor, or estimator. Although each is independent, each is far from impartial. They are advocates. Some may even argue each is an agent for their "client" (a foreshadowing of evidentiary concerns). These two advocates get together and attempt to agree on as much as possible. To the extent there is disagreement, if the appraisers or parties cannot agree upon an umpire, the court is petitioned to appoint one. The umpire is neither an appraiser nor an advocate for either party, but rather someone who on an item-by-item basis chooses one or the other until the claim is fully decided upon. That is the way appraisal was designed to proceed. Because an insurer should have already paid its insured whatever it believes it owed (presuming no coverage or forfeiture issues), appraisal should only benefit the insured. Apparently, insurers justify such a process upon the rationale it is less expensive and less risky than litigation. For an increasing number of claims, this rationale may no longer ring true.

* * *

. . . there are three voters, each with an equal vote. An award only requires two of the three signatures. By definition, one is always more favorable to the insured, while another is always more favorable to the insurer. That is, one advocates a high number, and the other advocates a low number. The third participant is somewhere in between, or, more typically, simply indifferent. What happens?

Assume appraiser number one argues that the covered damages are $10 million, while appraiser number two argues that these damages do not exceed $1 million. Assume the umpire believes that appraiser number two ($1 million) is probably right. Does the umpire sign-off on a $1 million award without obtaining the signature of appraiser number one? Possibly, but not likely. On the other hand, if the umpire believed that appraiser number one ($10 million) was probably right, would the two of them sign-off on a $10 million award? Again, possibly, but not likely.

What is likely to happen is that the umpire, looking to avoid conflict, and seeking consensus and credibility, goes to appraiser number one and says: "I am going to sign-off on appraiser number two's proposal of $1 million, unless you agree to sign-off on a compromise of $5.5 million." Devoid of an actual choice, appraiser number one agrees. The umpire then goes to appraiser number two and says: "I am going to sign-off on a $7.5 million award unless you agree to sign-off on a $5.5 million award." Devoid of choice, appraiser number two agrees. All three sign-off on an appraisal award of $5.5 million, notwithstanding the fact that not one believes that is the actual covered damage. Such a process is frightening, especially when one considers the potential consequences.

* * *

Catch 22

The insurer is faced with a $5.5 million appraisal award signed by all three "independent" arbitrators, including the one chosen by the insurer. Yet the claim has already been denied and the policy declared void because, in part, the insurer contends that the covered damages do not exceed $1 million. May the insurer litigate and try the breach of contract case? May the insurer be found to owe less than the amount of the appraisal award? May the insurer still argue that the insured's $10 million claim was intentionally inflated and thus the insured forfeits its rights to any insurance proceeds, including those awarded in appraisal? May the insurer argue that the insured's claim was intentionally inflated by $9 million, or is the insurer limited to arguing "only" a $4.5 million inflation? May the insured argue its $10 million claim is still true and accurate? May either party introduce the appraisal award as evidence? Are the appraisers or arbitrators witnesses? Are they expert witnesses? Are any of the appraisers or arbitrators considered agents of either party and thus their conduct (e.g., signing the award) or testimony is imputed to their respective "client?" What would be the arguments, and by whom, if the appraisal award had been $9 million? What would have been the arguments if the appraisal award had been $1 million? We have been unable to find any published decisions directly addressing these evidentiary issues in a post-appraisal insurance contract trial.

The insurer denied the claim in part because it determined that at least $5 million was caused by flood and, therefore, excluded from coverage. May the insurer still argue this at trial? Does the appraisal award preclude such argument? If such argument is allowed at trial, may the insured introduce the appraisal process and the appraisers as evidence to the contrary? The headache most courts believe they are medicating by compelling appraisal *before* the coverage and forfeiture issues are resolved is now back as a migraine.

The Ultimatum

Upon receipt of the $5.5 million appraisal award, the insured writes its insurer the following:

> Dear Gentlemen:
>
> Enclosed is a copy of the $5.5 million appraisal award signed by all three appraisers, including your own. Pursuant to your own appraisal clause, and the judgment of these

three independent experts, the amount of covered damages exceeds your evaluation by $4.5 million, or 450%. How can you, an expert in insurance, be wrong by $4.5 million? Nevertheless, if you pay me this award, plus interest, and reasonable attorney's fees, within the next ten days, I will execute a full release of any and all claims. If not, however, I will sue you for a breach of contract, fraud, and "bad faith." Obviously, I will seek punitive damages in order to deter you from continuing such wrongful conduct with others.

Sincerely yours,

Your Insured

Although the insurer is confident that the actual covered damages do not exceed $1 million, does it matter? How does the insurer explain its $1 million dollar evaluation in light of the "unanimous" appraisal award of $4.5 million *more*? If the appraisers testify, what will they actually say? No doubt at least one will testify that he was "forced" to sign for $4.5 million *lower* than he thought the insured was entitled. What will the "umpire" say? Will he have any competent expertise on the amount of damages, or will he admit that the process was political and resulted in a compromise to achieve at least the perception of consensus?

What happens if the insurer chooses not to settle? Assume the "bad faith" is bifurcated and stayed. A jury returns a verdict finding no forfeiture, yet agreeing with the insurer that the covered damages are "only" $1 million - - at best a bittersweet result for the insurer who must pay $4.5 million more as a result of the appraisal award. Does the insured still have a "bad faith" claim due to the insurer's refusal to pay that award a year earlier? Does the insured have a "bad faith" claim due to the insurer's failure to pay the $1 million a year earlier? Here we have the appraisal award, a political compromise, used as evidence of both covered damages and "bad faith." Obviously, this is far beyond its intended purpose - - to resolve dollar disputes.

What would happen if the jury's award was for the full amount of the appraisal award of $5.5 million? How do you evaluate the insurer's defense to the "bad faith" claim then? What is the insurer's defense - - "the politics of three?" The insured rebuts: "So what, the $5.5 million is determined by the terms of the contract you, the insurer, wrote. How can you excuse your failure to pay based upon a refusal to accept the result mandated by your own contract? What would you, the insurer, be arguing if the appraisal award was $1 million or less?" Implied is the cornerstone of American Jurisprudence: "What is good for the goose is good for the gander."

If the jury "awards" $5.5 million or more, the insurer could expect to receive another demand letter from the insured, this time including a substantial figure for punitive damages. In fact, such a letter would probably be sent even if the jury agrees with the insurer on the amount of covered damages, as long as it does not find a forfeiture.

Carcasses and Contagion

The effects of an appraisal award on the contract litigation can be calamitous. The choices, however, appear clear. One option is to allow everything into evidence and let the parties and their counsel argue and explain. This would include appraisers, umpires, and arbitrators as witnesses and, more than likely, as experts. One or more of them may actually be deemed agents of either the insured or the insurer and thus their conduct and testimony be considered that of their "client." The parties may have to present experts on the appraisal process. The contract case will become, in large part, a trial of the appraisal itself. Ironically, the process that was intended to reduce the expense and burden upon the judicial process will actually increase that burden, and, additionally, dramatically complicate it.

The second option is to allow none of it into evidence. The appraisal award acts solely as a contractual ceiling as a matter of law and nothing else. The case is tried before the jury as if there never was an appraisal or appraisal award. Any inconsistencies between the appraisal award and the verdict can be resolved by the court post-verdict as a matter of law (presumably with the

benefit of an interrogatory verdict form already completed by the jury). This option is consistent with the public policy objectives initially envisioned by the appraisal clause, and will reduce the complexity of the judicial process. This option may, however, deny a party's "right" to present otherwise admissible evidence. Of course, this latter issue would not be present if the existence and enforceability of the contract itself was determined before the remedy - - that is if the contract case was resolved before the appraisal award.

The third option is for insurers to rewrite the appraisal provision. This can be tailored to a particular jurisdiction and a particular line of coverage. However, one common element should be a clear statement that - - "appraisal cannot be invoked if there are any coverage or forfeiture issues." Hopefully, this would mean when appraisal is properly invoked, the result is final, and there cannot be a subsequent trial on contract resulting in the above-described confusion.

There is a fourth option. Insurers can eliminate the appraisal clause from their insurance contracts. If the insured and the insurer agree to submit the claim to appraisal or arbitration, they may still do so.

Conclusion

It is most revealing about the present state of our dispute resolution system that something as benign as an "appraisal" clause can actually become the ultimate battleground. A battleground where, paradoxically, issues of coverage and fraud are decided without even addressing them, and the "victor" proclaims either "bad faith" or "fraud." Such a process and result runs counter to any definition of justice.[1]

* * *

II. Nine Years Ago

Three years later, we continued to warn of the problems created with the judicial interpretation of the appraisal provision. We wrote:

> . . . *Johnson v. Nationwide Mut. Ins. Co.*[2] held that these *coverage* issues were to be judicially determined by the court and were not subject to determination by appraisers. That is, the determination of whether the *entire* loss was caused by a sinkhole or earth movement is an issue of coverage and thus an issue for judicial determination by a court. *See contra*, *Munn v. National Fire Ins. Co. of Hartford*, 115 So. 2d 54 (Miss. 1959) (nowhere in the standard form for submission to appraisal is any power vested in or conferred upon the appraisers to determine the cause of the loss, the value of which they shall appraise).

However, assuming the absence of a breach of contract argument against the insured, which even if it did exist may not bar appraisal (*See Scottsdale v. University at 107th Avenue, Inc.*[3], *infra*), if an insured demands appraisal, resolution by appraisal can only be avoided if the insurer denies the existence of *any* covered damages. *Johnson* dealt with multiple fact patterns where the insurers denied the existence of *any* covered damages. That is, the insurers contended *all* the damages claimed were caused by perils excluded from coverage.

The Florida Supreme Court in *Johnson*, however, holds that in many, if not most claims, causation can be determined by appraisal. For instance, how will *Johnson* impact the typical windstorm claim?

What happens when the next Category Four or Five hurricane strikes Florida? Since Hurricane Andrew (1992) and Hurricane Opal (1995), followed by the re-underwriting following 9-11, the windstorm deductibles in the state of Florida have increased dramatically. A $250,000 or 2% of insured value deductible is common. In the context of *Johnson*, envision multi-million dollar insurance claims where the insurer admits there is some "covered" windstorm damage, but it falls within the deductible. The insurer contends that although the property may have $10 million worth of damages, more than $9 million of it is pre-existing conditions, typically normal wear and tear, which is excluded from coverage. The insured, or more likely its public adjuster or attorney, writes back demanding appraisal. Assuming the insurer is not contending a breach of contract by the insured, can the insurer avoid appraisal? Under *Johnson* an argument could be made that

the "insurer admits that there is a covered loss, the amount of which is disputed." Thus, what most carriers would deem to be a *coverage* issue (application of its exclusions) that is excluded from appraisal and reserved solely for the courts to resolve, must now to be decided by an appraisal panel. To fully appreciate what this means, we recommend that you read further.

* * *

Appraisal affords essentially no due process protections. The case of *Allstate Ins. Co. v. Suarez*[4] holds that the appraisal clause is not arbitration and is not controlled by the Florida Arbitration Code. That is, the Florida Supreme Court has ruled that appraisal allows an insurer no voice in the appraisal process other than that provided by its designated appraiser. There is no hearing. There is no transcript. There is no taking of evidence. There are no witnesses. There are no arguments. There are no factual or legal briefs. There is simply whatever two of the three appraisers (one appraiser being designated by the insurer, another designated by the insured, and an umpire appointed by the court) deciding how much insurance proceeds the insurer must pay.

This appraisal process has no rules and no requirements. The appraisers and umpire may get together by phone and never meet. They may review all or none of the documents available. They may or may not visit the insured premises. They may decide the $10 million question over beers and a twenty-dollar lunch or they may take months to review and discuss. The umpire may meet with one appraiser outside the presence of the other. Note, by definition, the umpire decides the outcome of the appraisal award. There are neither requirements for the written appraisal award nor limitations. When the written appraisal award is rendered whether signed by all three appraisers or just one appraiser and the umpire, that award is sacrosanct. That is, absent evidence of fraud or collusion, the award is not appealable. The chances of setting aside such an award based upon fraud or collusion are almost nil. An appraiser can be the public adjuster who actually takes a percentage of the award as a fee, just as long as that interest is disclosed prior to the appraisal process. *Rios v. Tri-State Ins. Co.*[5]

Now, in the context of a substantial windstorm claim, where you have multi-million dollar estimates for sliding glass doors, tile roofs, water intrusion, water extraction, and mold remediation, involving twenty years of construction, defects, maintenance, repairs, and prior weather events, do you expect your appraiser to provide a compelling and persuasive argument for the application of contractual exclusions based upon "faulty workmanship" or "wear and tear" to an umpire who is willing to analyze the insurance contract to determine the application of such exclusions? Or, do you envision, at best, an umpire who patiently listens to both appraisers, and then, when tired of the particular "sticks and stones" commentary, seeks a compromise solution based upon dollars, not damages? Most umpires are neither experts in property damage nor property law.

Are property underwriters taking into account this phenomena where your exclusions are not given effect, but are essentially ignored? We doubt the present premiums charged for windstorm, even given the substantial increase in deductibles and self-insured-retentions take this "coverage-by-appraisal-fiat" into account.

Keep in mind, in this appraisal process, you will never know why the appraisal panel awarded what it did. There is no record. There is no opinion. There are no findings of fact or conclusions of law. There is nothing to appeal or argue against. The appraisal panel speaks and the insurer must pay, regardless of whether the damages were actually *caused* by the *covered* event or not.[6]

* * *

Obviously, many courts see appraisal as alternative dispute resolution, and absent corruption, the results of which will not be disturbed.

* * *

. . . Nine months later the appraisal award is for $5 million, well above the $250,000 windstorm deductible, but $5 million below the actual claim and policy limits. The insurer, having no recourse, pays the appraisal award within the time

prescribed by the Loss Payable clause. The insurer does not pay any interest, costs, or attorney fees, and certainly does not pay for any alleged consequential or punitive damages. The insured then serves and files a suit for "bad-faith" pursuant to the Florida statutory scheme and proceeds to conduct burdensome and intrusive discovery upon the insurer.[7]

The cornerstone of the insured's argument is that the appraisal award of $5 million awarded pursuant to the terms of the insurance contract, which is more than $4.75 million than that contended by the insurer as covered damages, and which was signed by the insurer's appraiser as well, is evidence of the insurer's bad-faith. The insured argues that the insurer knew or should have known that the covered damages were $5 million, but chose to argue otherwise. The two appraisers and umpire knew no more than the insurer knew or should have known nine months before, yet the insurer, the expert in determining property damages and adjusting insurance claims pursuant to the terms and conditions of the insurance policy, wrongfully, if not maliciously, argued that the damages did not exceed the $250,000 deductible.

Is the appraisal award itself admissible evidence in the "bad-faith" trial? If so, can the appraisers and umpire be deposed and their fact gathering process and decision making process be disclosed through deposition and trial testimony? Is the insurer estopped from asserting that the actual covered damages are indeed less than the $5 million awarded by the appraisal panel? Presently the authors are unaware of any published decision addressing such issues. However, as long as the law on appraisal remains as is, and property insurers issue policies with appraisal clauses, these issues will eventually be addressed by the courts.

Tomorrow

* * *

A property insurer should give serious and immediate consideration to removing its appraisal clause.[8]

* * *

If you didn't consider removing the appraisal clause back then, you should most certainly consider doing so now.

III. The Last Few Years

As predicted, over the last few years, Florida courts have continued misconstruing the appraisal provision. In a string of recent appellate decisions, Florida has ruled that if an insured requests appraisal and the insurer refuses, the trial court must hold an evidentiary hearing to determine whether the insured has complied with its post-loss contractual obligations.[9] Apparently, if the trial court determines that the insured has complied with its post-loss contractual obligations, then the court orders appraisal. If the trial court determines that the insured has not complied with its post-loss contractual obligations, then appraisal is denied, presumably allowing the insurer to litigate and try its affirmative defenses before a jury. If that happens, presumably the insurer can raise the affirmative defense that insurer failed to satisfy its post-loss contractual obligations.

Unfortunately, none of these appellate decisions provide any standards or procedures for such a process. For instance, it is unclear what is the legal standard the trial court should use in deciding whether the insured has complied with its post-loss contractual obligations. Those post-loss contractual obligations are conditions precedent to an insured's right to demand appraisal. The Florida appellate courts are silent on that issue. We have argued that the only standard that makes sense is the standard for summary judgment. That is, in order for the Court to order appraisal when the insurer has raised the affirmative defense that the insured has failed to comply with its post-loss contractual obligations, the insured must establish there is no genuine issue as to any material fact as well as entitlement as a matter of law. If any other standard is applied, the insurer has been denied its constitutional right to a jury trial on those affirmative defenses?[10] We are still waiting for the Florida courts to address these issues.

IV. Today

On September 5, 2012, a Florida appellate court issued another troublesome decision on appraisal and insurance "bad-faith." The appellate court held that, if an insured receives monies pursuant to an appraisal award,

that constitutes a "favorable resolution of an underlying breach of contract dispute for purposes of filing a 'bad-faith' cause of action." In the case of *Trafalgar at Greenacres, Ltd. v. Zurich American Insurance Company*,[11] a shopping center was damaged by Hurricane Wilma in 2005. The property insurer set its initial reserves at $1,500,000. Why the appellate court made note of this is itself troublesome because it has no relevance to its rationale or holding.[12] Within three months, the insurer issued a check for $468,381.30 after subtracting the $150,000 deductible. In April 2006, the insurer paid an additional $112,475.10. In June 2006, the insured submitted a Sworn Statement in Proof of Loss claiming total Hurricane Wilma damages of $1,826,938.54. The insurer responded that it was continuing to investigate the claim. In September 2006, eleven months after the storm, the insured filed a lawsuit pleading that the insurer breached the insurance contract by failing to pay all monies due to it under that insurance contract. One month later, the insurer advised its insured that its investigation was complete. The insurer then tendered an additional payment, bringing the total payments to $641,730.32.

The insurer then demanded appraisal pursuant to the appraisal provision of the insurance contract. A year later an appraisal award was issued in the amount of $1,504,663.10. The insurer fulfilled its contractual obligations by timely paying the insured the full amount of the appraisal award after appropriately subtracting the prior payments and the deductible. The insured then filed a motion to confirm the appraisal award, seeking entry of a judgment in its favor as well as an award of attorney fees and costs. The insurer moved for summary judgment that it is not liable for breach of contract based upon its timely payment of the appraisal award pursuant to the terms of the insurance contract. The trial court granted the insurer's motion for summary judgment. The trial court denied the insured's motion for entry of judgment and claim for fees and costs. However, the trial court granted the insured's motion for leave to amend its complaint to state a cause of action for statutory "bad-faith." The trial court deemed the proposed amended complaint to be filed on the date the summary judgment in favor of the insurer was entered.

The insurance "bad-faith" claim alleged that the insurer engaged in a pattern of delay and denial before and after litigation was filed. The insurer countered that since the trial court had determined that it was not liable for breach of the insurance contract, the insured failed to obtain a "favorable" resolution of the underlying breach of contract claim. The trial court granted the insurer's motion for summary judgment, stating that if the insurer did not breach its contract, there cannot be any favorable resolution of the underlying breach of contract claim to allow the insured to pursue a statutory "bad-faith" claim. Unfortunately the Florida appellate court erroneously held otherwise.

Curiously, the appellate court noted that the trial court recognized the appraisal award more than doubled what the insurer previously paid before suit was filed and was approximately one-half of the insured's demand. However, as with the "reserves," those facts are irrelevant to *Trafalgar*'s rationale and holding. *Trafalgar* says:

> It is well settled that a statutory first-party bad faith action is premature until two conditions have been satisfied: (1) the insurer raises no defense which would defeat coverage, or any such defense has been *adjudicated* adversely to the insurer; and (2) the actual extent of the insured's loss must have been determined. *Vest v. Travelers Ins. Co.*, 753 So. 2d 1270, 1273 (Fla. 2000) (citing *Blanchard v. State Farm Mut. Auto. Ins. co.*, 575 So. 2d 1289, 1981 (Fla. 1991). In *Blanchard*, the court explained that "an insured's underlying first-party action for insurance benefits against the insurer necessarily must be resolved favorably to the insured before the cause of action for bad faith in settlement negotiations can accrue." *Id.* Once a determination has been made as to *liability* and the extent of damages, there is no impediment to pursuing a bad faith claim. While it is necessary that there be a determination of the insured's damages, there is no requirement that the insured's underlying claim be by a trial or arbitration. *See Imhof v. Nationwide Mut. Ins. Co.*, 643 So. 2d 617 (Fla. 1994). Rather, *all that is required is "a resolution of some kind in favor of the insured." Vest*, 753 So. 2d at 1274. (*Emphasis* supplied).

This is where *Trafalgar* and its predecessors have gone wrong. A first-party insurer cannot be legally liable for

insurance "bad-faith" when it has fulfilled all its contractual obligations to its insured.

V. A Breach Of The Insurance Contract Must Be A Condition Precedent to 'Bad-Faith'

In order for a first-party insurer to be legally liable for insurance "bad-faith," *the insurer must be liable for breach of that insurance contract*.[13] The relationship between a first-party insurer and its insured is that of a creditor/debtor.[14] The law of contracts applies. If that insurer has performed its contractual obligations to its insured, it cannot be legally liable for insurance "bad-faith." Even in jurisdictions that use the "fairly debatable" standard to determine liability for insurance "bad-faith," how can an insured overcome that standard if the insurer never breached any of its contractual obligations to its insured? It is, and should be, legally impossible.[15]

Trafalgar cites to *Blanchard*, *Imhof*, *Vest*, and *Dadeland Depot*. In *Blanchard*, the insured was injured in an automobile accident. According to the insured, its insurer refused to make a good faith offer to settle the uninsured motorist coverage claim. The insured then filed a lawsuit against the tortfeasor for negligence and against the insurer for failing to pay under the insurance contract. The insured won a verdict in excess of the insurer's policy limits. No appeal was taken from the state court judgment. Thus in *Blanchard*, the first-party insurer arguably was found *legally liable for breach of its insurance contract*. The Florida Supreme Court in *Blanchard* expressly stated:

> *. . . an insured's underlying first-party action for insurance benefits against the insurer* necessarily must be resolved favorably to the insured before the cause of action for bad faith in settlement negotiations can accrue. . . Absent a determination of the existence of *liability* on the part of the uninsured tortfeasor and the extent of the plaintiff's damages, a cause of action cannot exist for a bad faith failure to settle (*emphasis* supplied).

Because *Blanchard* is an uninsured motorist case, it is difficult to apply its language regarding a tortfeasor and injuries to a first-party case not involving an uninsured motorist policy. However, *Blanchard* strongly suggests that there must be a determination that the insurer was *legally liable for breach of its own insurance contract with its insured* before a "bad faith" action can ripen.

In *Imhof v. Nationwide Mut. Ins. Co.,*[16] the Florida Supreme Court again dealt with an underinsured/uninsured first-party insurance contract. Imhof made a claim against its insurer for uninsured coverage. He alleged in his complaint an action for insurance "bad-faith" stating that the insurer failed to respond to his request for benefits. Imhof filed a Civil Remedy Notice of Insurer Violation under § 624.155, Florida Statutes. In the Notice, Imhof stated that he had offered to settle for the policy limits of $200,000 and had been ignored, and that he had later renewed the offer and that the insurer had failed to acknowledge even the renewed offer. Imhof's counsel said during oral argument that the insurer did not respond to the Civil Remedy Notice during the 60 day period provided by the statute. Imhof filed a complaint on June 7, 1990 alleging "bad-faith" on the part of insurer. The complaint did not allege that there had been a determination of Imhof's damages. The trial court dismissed the complaint with prejudice for failing to state a cause of action. On appeal, the First District Court of Appeal affirmed, finding that the complaint did not state a cause of action because it did not allege that there had been a determination of the extent of Imhof's damages. The court found that this is a requirement under *Blanchard* to bring an action for insurer "bad-faith." However, the court certified the question of whether a failure to allege that there had been a determination of damages barred an action for "bad-faith" damages under the statute. The Florida Supreme Court said yes. The Court wrote:

> In *Blanchard* we held that '[a]bsent a determination of the existence of *liability* on the part of the uninsured tortfeasor and the extent of the plaintiff's damages, a cause of action cannot exist for a bad faith failure to settle.' In the instant case, Imhof failed to allege in his complaint that a determination of his damages had been made. Thus, the trial court correctly dismissed the complaint for failure to state a cause of action.
>
> Neither *Blanchard* nor § 624.155(2)(b) requires the allegation of a *specific amount* of damages. Thus, if the First District Court's certified question asked whether a complaint

> must allege the specific amount of damages determined, we would answer that question in the negative.

Here we can see the confusion caused by addressing an uninsured motorist case. Arguably these cases are holding that, once the insured prevails in its lawsuit against the "tortfeasor" or against the uninsured motorist carrier that is arguing the tortfeasor is not liable, that somehow is a "favorable result" against the insurer providing legal standing for that insured to bring an insurance "bad-faith" suit against that insurer. It is the authors' position that if, and only if, such a determination also constitutes a breach of the insurance contract by the carrier for failing to pay the insurance benefits when it was contractually obligated to pay them, the insured has standing to bring a first-party insurance "bad-faith" action against its insurer. Why should it be otherwise? If an insurer has fulfilled all its contractual obligations to its insured, why should insurance "bad-faith" be an issue?

It is important to note Justice Grimes concurring opinion and Justice McDonald's dissent in *Imhof*. Justice Grimes stated:

> . . . I write only to explain why Imhof should be permitted to amend his complaint to allege that he obtained a favorable arbitration award. The insurer originally moved to dismiss the complaint because there was no allegation that Imhof had obtained an arbitration award in excess of the policy limits. Imhof did not contest the dismissal of the complaint without leave to amend because he could not allege that his award exceeded the policy limits. It is clear from the appellate briefs that the question of whether there had to be an arbitration award in excess of the policy limits continued to be the primary issue before the district court of appeal.
>
> In the interim, however, this Court rendered its opinion in *Blanchard* in which we said that absent a determination of *liability* and damages on the part of the uninsured torteasor a cause of action could not exist for a bad faith failure to settle. Because of our holding in *Blanchard*, the district court of appeal affirmed the dismissal of the complaint on the basis that there was no allegation in the complaint that Imhof had obtained any award . . . There has never been any doubt that Imhof obtained a favorable arbitration award . . .

But then one must read Judge McDonald's dissent:

> . . . Imhof and the insurer agreed *in the contract* between them to arbitrate any dispute on the amount of damages. The insurer had a right to rely on this provision. Arbitration was accomplished and the amount awarded was within the coverage. Under the circumstances the trial court correctly dismissed Imhof's claim.

Of course, Justice McDonald is correct. If an insurer complies with the terms and conditions of its insurance contract, including a contractual arbitration (*Imhof)* or appraisal provision (*Trafalgar)*, then that first-party insurer cannot be legally liable for insurance "bad-faith." Nevertheless, neither *Blanchard* nor *Imhof* provide any legal support for the proposition that a first-party insurer can be held legally liable for insurance "bad-faith" when that insurer is expressly found *not* to be liable for breach of the insurance contract, as it was in *Trafalgar*.

In *Vest v. Traveler's Ins. Co.,*[17] again dealing with an uninsured motorist claim, the Supreme Court again quoted itself in *Blanchard*:

> Absent a determination of the existence of liability on the part of the uninsured tortfeasor and the extent of the plaintiff's damages, a cause of action cannot exist for a bad faith failure to settle.

Because the Court was dealing with uninsured motorist coverage, the liability of the tortfeasor would be the liability of the first-party insurer providing uninsured motorist coverage. The Supreme Court in *Vest* further wrote:

> The issue in the present case is whether an insured's damages incurred by reason of a violation of § 624.155(1)(b)1 are recoverable from the date that the conditions for payment of benefits under the policy have been

> fulfilled even though those damages are incurred prior to the determination of *liability* or the extent of damages, which is necessary for the accrual of the cause of action pursuant to *Imhof* and *Blanchard* . . .There was no establishment of *liability* until a settlement was authorized with the tortfeasor . . . Under these facts, we conclude that the question to be answered is whether *Imhof* and *Blanchard* preclude recovery as a matter of law for bad-faith damages allegedly incurred from the date when all the conditions precedent for payment of the contractual policy benefits had been fulfilled because these damages were incurred prior to the settlement with the tortfeasor . . . The district court held that the answer to this question is yes. However, we do not agree. This reading of *Imhof* and *Blanchard* is too restrictive . . . (*Emphasis* supplied).

Nevertheless, the Supreme Court in *Vest* expressly stated:

> We expressly state that *Blanchard* is properly read to mean that the "determination of the existence of liability on the part of the uninsured tortfeasor and the extent of the [insured's] damages" are elements of a cause of action for bad faith. Once those elements exist, there is no impediment as a matter of law to a recovery of damages for violation of § 624.155(1)(b)1 dating from the date of a proven violation . . .
>
> In sum, we expressly hold that a claim for bad faith pursuant to § 624.155(1)(b)1 is founded upon the obligation of the *insurer* to pay *when all conditions under the policy would require* an insurer exercising good faith and fair dealing towards its insured to pay. *This obligation on the part of an insurer requires the insurer to timely evaluate and pay benefits owed on the insurance policy*. To proceed in a claim for bad faith an insured must send a notice pursuant to § 624.155(1)(b)1. The insurer then has sixty days in which to respond and, *if payment is owed on the contract, to cure the claimed bad faith by paying the benefits owed on the insurance contract . . . What is owed on the contract is in turn governed by whether all conditions precedent for payment contained within the policy have been met* . . . (*Emphasis* supplied).
>
> We continue to hold in accord with *Blanchard* with bringing cause of action in Court for violation of § 624.155(1)(b)1 is premature *until there is a determination of liability and extent of damages owed on the first-party insurance contract* . . . (*Emphasis* supplied).

Obviously *Vest* is confusing because of the uninsured motorist context.[18] If this whole uninsured motorist process is required to determine how much the uninsured motorist carrier owes under its insurance contact, and not intended to determine if that uninsured motorist carrier actually has breached that insurance contact by failing to pay such benefits, then how can there be legal standing to pursue an insurance "bad-faith" claim?[19] Moreover, why should there be? Nevertheless, clearly *Vest* provides no support for the proposition that a first-party insurer can be held liable for insurance "bad-faith" in the absence of it being liable for breach of the insurance contract.[20]

The last and most recent case cited by *Trafalgar* in support of its decision is *Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins. Co.*[21] *Dadeland Depot*, also references *Blanchard* and *Imhof*, standing for the proposition that a surety can be sued for insurance "bad-faith" in the absence of it being held legally liable for breach of its insurance contract or bond. First, the surety was held legally liable by way of a construction arbitration process whose mandate was to determine legal liability for breach of contract as well as tort. Nevertheless, *Dadeland Depot* is wrongly decided, as the dissents so clearly and correctly state:

* * *

> In sum, I do not understand how this is a "bad faith" claim against the surety, because Dadeland has suffered no cognizable damages for which Dadeland has not been timely paid by the principal of the bond once what was owed was determined by arbitration. Thus there are no damages to be recovered in a bad-faith action against the surety.

To subject a surety to bad-faith damages in a situation in which a solvent contractor-principal pays to an owner-obligee what is fully owed within a reasonable time after the amount owed by the principal is determined in an agreed-to arbitration does not stand the test of either law or logic. The majority's result ignores how practically construction contract surety works. Importantly, a surety has a right to subrogation against the contractor's principal, making it necessary in the workings of the surety-principal-obligee relationship to have determined what the principal owes before the surety makes a payment.

* * *

The differences between a construction performance surety bond and an insurance policy are many and important. They begin, of course, with the self-evident fact that in an insurance policy there is an insurer (the insurance company) and an insured (the person or entity who has an insurable interest). In a surety situation, the contract is not called an insurance contract, the contract is called a "bond."

* * *

Finally, in answer to the third certified question, I believe that Judge Hurley was precisely correct in stating:

> Plaintiffs argue that there has, in fact, been a finding of liability against the sureties under the performance bond, and an assessment of damages. Plaintiffs cite the arbitration panel's ruling that "[t]he Surety is bound to this award to the extent that its principal is obligated under the award and its defenses are denied." However, plaintiffs have misinterpreted the panel's decision. The arbitrators' finding that Walbridge was partially liable for breach of the construction contract did not constitute a finding that the sureties had breached their obligations under the separate performance bond. A sensible reading of the decision indicates that the sureties would be liable for the damages assessed against Walbridge only if Walbridge was unable or unwilling to pay the award. But the sureties already owed a contractual duty, under paragraph 6.1 of the performance bond, to correct defective work performed by the contractor in the event of a contractor default. *The panel did not impose any liability on the sureties that did not already exist under the terms of the performance bond.*
>
> *Conceivably, had the arbitration panel ruled that the sureties had breached the contract and were liable for a sum certain, then, and only then, would plaintiffs be able to state a claim for bad-faith claims handling against the sureties. Since there has been no underlying judicial finding that the sureties in-fact failed to perform their obligations under the bond, nor have the sureties tendered payment for a claim or entered into a settlement agreement with the principal or the obligees, plaintiffs cannot demonstrate that the conditions precedent to a bad-faith refusal-to-settle claim have been satisfied.* (*Emphasis* supplied).

What makes the *Trafalgar* decision even more surprising is that on August 15, 2012, three weeks before the *Trafalgar* decision was issued, the same Florida appellate court issued an opinion in *Lime Bay Condo., Inc. v. State Farm Florida Ins. Co.*[22] *Lime Bay* addressed the "liability" requirement for proceeding with a "bad-faith" claim. In *Lime Bay*, the insured sustained damage due to Hurricane Wilma. After the insurer paid the undisputed damages, $6,940.46, the insured filed a Civil Remedy Notice and a breach of contract lawsuit. The breach of contract lawsuit was stayed pending appraisal. The appraisal award came back at $1,051,251.41. The insurer timely paid the appraisal award. The insured filed a "bad-faith" complaint. The insurer moved to dismiss. The Florida appellate court held,

> Lime Bay did not, and could not, allege that there had been a final determination of liability since the breach of contract case was still pending. *See Blanchard v. State Farm Mut. Auto. Ins. Co.*, 575 So. 2d 1289, 1291 (Fla. 1991) (holding that an insured's bad faith claim does not accrue "before the conclusion of the underlying litigation for

> the contractual ... insurance benefits"). Rather, the trial court must first resolve the issue of State Farm's liability for breach of contract, as well as the significance, if any, of the appraisal award. *See State Farm Fla. Ins. Co. v. Seville Place Condo. Ass'n*, 74 So. 3d 105, 108 (Fla. 3d DCA 2011) (commenting that a bad faith action is premature until the insurer raises no defense that would defeat coverage which is "an issue for the judicial process rather than the appraisal process"), *review dismissed*, 91 So. 3d 133 (Fla. 2012). Thus, the trial court's order dismissing the bad faith complaint is affirmed.[23]

Lime Bay held that liability in the breach of contract case was a prerequisite to proceeding with a "bad-faith" claim even though the appraisal award was approximately 175 times the amount paid by the insurer. But then, three weeks later, the same appellate court wrote *Trafalgar*.

VI. The Troubles of *Trafalgar*

The *Trafalgar* troubles are innumerable. However, we will attempt to identify a few.

First, according to *Trafalgar* legal liability for breach of the insurance contract is not necessary. There could be no breach of the insurance contract and no lawsuit and *Trafalgar* would have made the same decision. If there is ever a dispute between a first-party insurer and its insured through the course of an adjustment, and subsequently the insured obtains a "favorable resolution" of the dispute, presumably by the insurer paying the insured additional monies, that seems to be sufficient for the *Trafalgar* court to say that the insured now has standing to bring forth an insurance "bad-faith" claim. Of course, this is preposterous, and we are confident the *Trafalgar* court would say this is not what it meant. Unfortunately, this is what the *Trafalgar* court has written.[24]

Second, this means that if any insurer pays its insured millions of dollars, but the insured demands it is owed a few dollars more, if the insurer demands appraisal, and the insured is awarded a dollar more, resulting in a "favorable resolution," the insured has legal standing to pursue an insurance "bad-faith" lawsuit against its first-party insurer who has not breached the insurance contract and who has paid 99.9% of the amounts owed even before the appraisal panel issued its appraisal award.

Third, implicit, if not explicit, in the *Trafalgar* decision is that appraisal award itself is somehow evidence of insurance "bad-faith." Therefore, the appraisal award would be admissible evidence in the subsequent "bad-faith" litigation at trial. Would the parties be allowed to depose the appraisers and the umpire? Would the appraisers and umpire be obligated to answer questions concerning their analysis, thought process, calculations, negotiations, and determination? Appraisers and umpires conduct their activities under the belief that such activities are confidential and are never to be scrutinized by anyone, certainly not by attorneys in deposition, and least of all during cross-examination in trial. Has such confidentiality now been discarded?

Or, are the courts going to say this appraisal award, which almost always is determined by compromise, and not subject to the checks and balances that the judicial process provides concerning evidence, expert testimony, hearsay, cross examination, and the like, will simply be allowed to be introduced as admissible evidence without explanation or justification. Do we ignore the Rules of Evidence? Are we going to be allowed to explain to the jury how or why the appraisal award came about other than it is simply a result of the insurance contract? So, is *Trafalgar* stating that any time there is an appraisal award favorable to the insured, that constitutes insurance "bad-faith"? And, should the appraisal award be substantially higher than the amounts of monies already by the insurer, would that constitute evidence of "bad-faith" against the insurer and the insurer not allowed to preclude such an award from being admitted into evidence, while at the same time not allowed to conduct discovery to determine how those dollar figures were determined and why?

Fourth, the *Trafalgar* court also erroneously references that there is no difference between an appraisal award and an arbitration award or apparently, for that matter, judgment as a result of a lawsuit for breach of the insurance contract. There *are* fundamental differences.[25] If there is a proceeding outside the terms and conditions of the insurance contract to determine whether the insurer is actually liable for breach of that insurance contract, such as a lawsuit for breach of contract or possibly an arbitration decision, then such

results of legal liability for breach of contract *would* meet the conditions precedent for an insured to have legal standing to pursue an insurance "bad-faith" claim. However, when there is no determination of legal liability for breach of contract, but rather the provision of the insurance contract, such as the appraisal provision that does not determine legal liability or whether either party has breached the insurance contract, but rather simply determines the scope of the damages, *that is not* the equivalent of a lawsuit or an arbitration panel finding that an insurer is legally liable for breach of contract.

VII. Conclusion

Once again the Courts have encouraged submission of inflated insurance claims and the abuse of the appraisal process. Moreover, *Trafalgar* will encourage frivolous demands for appraisal followed by frivolous lawsuits for insurance "bad-faith."[26]

Clearly, the history of the law, the statutory scheme, the debtor/creditor relationship between a first-party insurer and its insured, and the law of contracts, require that if a first-party insurer is found *not* to have breached its insurance contract, it cannot be held liable for insurance "bad-faith." Moreover, a condition precedent to bringing a lawsuit for insurance "bad-faith" against its own insurer must be that the insurer has breached that insurance contract. So we return to the question we began with, "How can a first-party insurer be legally liable for insurance "bad-faith" if it has been legally found *not* to have breached the insurance contract?" The correct answer is: it cannot be. Let's step back and look at this issue from a slightly different perspective. If an insurer has complied with all its contractual obligations to its insured, why are we even discussing legal liability for insurance "bad-faith?"

One of the legacies of *Trafalgar* will be, and should be, the elimination of the appraisal clause from the insurance contracts, which no doubt would constitute an unintended consequence of all the above noted judicial decisions. The Honorable Jeffrey A. Winikoff, the trial Judge in *Trafalgar*, described the situation accurately and succinctly during a May 22, 2008 hearing in this case:

> The Court: *Counsel, let me make it real simple for you. If I were to suggest that every time an insurer elects appraisal, goes through the appraisal process and pays more than they were offering prior to appraisal, that they're guilty of statutory bad-faith, we are going to throw alternative dispute resolution out. There's going to be nothing but bad-faith. That's not happening in this Court.*

Endnotes

1. John J. Pappas and John M. Odom, *"Armageddon,"* Mealey's Litigation Report: Insurance Bad Faith, Vol. 13, #18 (January 18, 2000).
2. 828 So. 2d 1021 (Fla. 2002).
3. 827 So. 2d 1016 (Fla. 3d DCA 2002).
4. 833 So. 2d 762 (Fla. 2002).
5. 714 So. 2d 547 (Fla. 3d DCA 1998).
6. In the case of *North Carolina Farm Bureau Mut. Ins. Co. v. Harrell*, 557 S.E. 2d 580 (Ct. App. N.C. 2001), a North Carolina Appellate Court stated:

> Arbitrators are not required to articulate reasons for their award.
>
> * * *
>
> In arbitration, errors of law or fact . . . are insufficient to invalidate an award fairly and honestly made.
>
> * * *
>
> An arbitrator who errors as a matter of law, exceeding his powers, is not subject to the vacating of his award because such an erroneous decision of a matter submitted to arbitration is insufficient to invalidate an award fairly and honestly made.
>
> * * *
>
> An award is intended to settle the matter in controversy, and thus save the expense of litigation. If a mistake be a sufficient ground for setting aside an award, it opens the door for coming into court in almost every case; for nine cases out of ten some mistake either law or fact may

be suggested by the dissatisfied party. Thus . . . arbitration instead of ending would tend to increase litigation.

* * *

Subsequently, in the case of *Harleysville Mut. Ins. Co. v. Narron*, 574 S.E. 2d 490 (Ct. App. N.C. 2002), another North Carolina Appellate Court wrote:

> We further find that there was no reason to invalidate the appraisal award based upon what Plaintiff alleged was O'Leary's mistake in setting the amount of loss to include non-hurricane damage. We have previously held that mistakes by appraisers, like those made by arbitrators, are insufficient to invalidate an award fairly and honestly made.

7. John J. Pappas, "*Florida's First-Party Bad-Faith Law.*" Mealey's Litigation Report: Insurance Bad Faith, Vol. 18, #12 (October 19, 2004):

> . . .
> The operative statutory language of Fla. Stat. § 624.155 is contained in sub-section (1)(b)1 that states:
> (1) Any person may bring a civil action against an insurer when such person is damaged . . .
> . . .
> (b) By the commission of any of the following acts by the insurer.
> 1. Not attempting in good faith to settle claims when, under all the circumstances, it could and should have done so, had it acted fairly and honestly towards its insured and with due regard for her or his interests. . .
>
> * * *
>
> *II. Condition Precedent*
> There is a required condition precedent to bringing a first-party "bad-faith" action against an insurer, Florida Statute § 624.155(3)(a) states:
> (3)(a) As a condition precedent to bringing an action under this section, the department and the authorized insurer must have been given 60 days written notice of the violation. If the department returns a notice for lack of specificity the 60-day time period shall not begin until a proper notice is filed.
>
> * * *
>
> (d) No action shall lie if, within 60 days after filing notice, the damages are paid or the circumstances giving rise to the violation are corrected.
>
> * * *

8. John J. Pappas, *"Appraising Windstorm Claim,"* Mealey's Litigation Report: Insurance Bad Faith, Vol. 17, #4 (June 18, 2003).

9. *Sunshine State Ins. Co. v. Corridori*, 28 So. 3d 129 (Fla. 4th DCA 2010) (ruling that a trial court had to review competent evidence and resolve coverage disputes before ordering appraisal); *Citizens Prop. Ins. Corp. v. Maytin,* 51 So. 3d 591 (Fla. 3d DCA 2010) (holding that the trial court must conduct an evidentiary hearing to determine whether the insured complied with the policy's post-loss conditions); *Citizens Prop. Ins. Corp. v. Galeria Villas Condo. Ass'n, Inc.*, 48 So. 3d 188 (Fla. 3d DCA 2010) (reversing order compelling appraisal and remanding to require the insured to establish that it provided records requested by Citizens and provided Citizens with reasonable access to property for inspections); *Citizens Prop. Ins. Corp. v. Mango Hill Condo. Ass'n 12 Inc.*, 54 So. 3d 578, 582 (Fla.3d DCA 2011) (reversing the order compelling appraisal and remanding for an evidentiary hearing on whether the insured sufficiently complied with the policy's post-loss requirements); *Citizens Prop. Ins. Corp. v. Gutierrez*, 59 So. 3d 177, 179 (Fla. 3d DCA 2011) (holding that the trial court erred in both granting the motion to compel appraisal and in failing to conduct the requested evidentiary hearing concerning the insureds' compliance with the policy's post-loss conditions); *Citizens Prop. Ins. Co. v. De Los Cuetos*, 88 So. 3d 249 (Fla. 3d DCA 2011) (reversing the trial court's non-final order compelling appraisal and remanding for an evidentiary hearing to determine whether post-loss obligations were met); *Citizens Prop. Ins. Corp. v. Admiralty House, Inc.*, 66 So. 3d 342 (Fla. 2d DCA 2011) (reversing the order compelling appraisal and remanding for an evidentiary hearing because the court failed to make the preliminary determination as to whether the insured's demand for appraisal was ripe); *United Prop. and Cas. Ins. Co. v. Tuff*, 60 So. 3d 592 (Fla. 3d DCA 2011) (reversing the trial court's non-final order compelling appraisal and remanding for an evidentiary hearing to determine whether post-loss obligations were met); *Citizens Prop. Ins. Corp. v. Congregation Adas Dej Maclei Zedex*, 62 So. 3d 1278 (Fla. 3d

DCA 2011) (reversing the trial court's non-final order compelling appraisal and remanding for an evidentiary hearing to determine whether post-loss obligations were met); *Universal Prop. and Cas. Ins. Co. v. Abbott*, 63 So.3d 924 (Fla. 3d DCA 2011) (reversing order in which the court compelled appraisal without conducting an evidentiary hearing); *United Prop. and Cas. Ins. Co. v. Concepcion*, 83 So. 3d 908, 910 (Fla. 3d DCA 2012) (reversing the trial court's order compelling appraisal and remanding the case for an evidentiary hearing on the issue of compliance with post-loss obligations under the policy. Noting that the argument of counsel does not constitute evidence); *Citizens Prop. Ins. Corp. v. Michigan Condo. Assoc.*, 46 So. 3d 177, 178 (Fla. 4th DCA 2010) (holding that a court must resolve all underlying coverage disputes prior to ordering an appraisal and certifying conflict with *Sunshine State Ins. Co. v. Rawlins*); *Sunshine State Ins. Co. v. Rawlins*, 34 So. 3d 753 (Fla. 3d DCA 2010) (allowing an appraisal to proceed on a "dual track" basis while purporting to preserve an insurer's right to contest coverage post- appraisal). Absent a waiver of the constitutional right to trial by jury, a judge may not consider issues properly raised in the pleadings that should be heard by a jury. *See Stewart v. Universal Invs. Unlimited, Inc.*, 553 So. 2d 385, 385 (Fla. 3d DCA 1989) (reversing judgment after bench trial where party demanded a jury trial and did not affirmatively waive that right).

10. Article 1, Section 22 of Florida Constitution provides that: "[t]he right of trial by juries shall be secure to all remain inviolate." *See also*, Fla.R.Civ.P. 1.430(a) (The right of trial by jury is declared by the Constitution or by statute shall be preserved to the parties in violate."). The right to a jury trial applies to actions cognizable at law, including breach of contract cases. *Construction Systems & Engineering, Inc. v. Jennings, Corp.*, 413 So. 2d 1236, 1237 (Fla. 3d DCA 1982); *Olin's, Inc. v. Avis Rent-A-Car Systems of Florida*, 131 So. 2d 20, 21-22 (Fla. 3d DCA 1961).

11. — So. 3d ——, 2012 WL 3822215 (Fla. 4th DCA Sept. 5, 2012).

12. "[R]eserves are, simply, not relevant. Defendant's assessment or its underwriter's assessment or its counsel's assessment of exposure to liability in this or prior cases has nothing to do with whether here there is liability. Furthermore, to allow evidence of the amount of reserves set aside for any particular incident would get this trial into mini-litigations over what was in the minds of the persons who set the reserve to uncover why each particular reserve was set (which would likely have depended on various factors besides an assessment of potential liability)." *Sundance Cruises Corp. v. American Bureau of Shipping*, 1992 WL 75097 (S.D.N.Y. Mar. 31, 1992).

13. *Liberty Mutual Ins. Co. v. The Farm, Inc.*, 754 So. 2d 865 (Fla. 3d DCA 2000).

14. John J. Pappas, "*What Everyone Should Know About A First-Party Property Claim – But Is Afraid to Ask,"* Mealey's Litigation Report: Insurance Bad Faith (Vol. 24, #22 March 24, 2011).

15. David H. Shaw, II, Esq., "*Statutory Bad-Faith Claims Following An Appraisal Award in Florida,"* Mealey's Litigation Report: Insurance Bad Faith, Vol. 23, #14.

View that a Bad-Faith Claim Cannot be Maintained Absent A Breach Of Contract

The Florida Second District Court of Appeal has recently affirmed two orders granting summary judgment in favor of insurers in bad-faith actions where there had been no underlying finding of breach of contract. In *Huffman v. State Farm Florida Ins. Co.*, the parties disagreed with the amount of loss and the insurer invoked appraisal pursuant to the policy. The appraisal panel issued an appraisal award and the insurer paid the amount of the appraisal award within the time period prescribed by the insurance policy. The insured then filed a bad-faith action. The insurer filed a motion for summary judgment which argued the bad faith action did not accrue until such time as the insured brought a breach of contract action and established that the insurer breached the contract. The trial court granted summary judgment in favor of the insurer, explaining that: "[b]efore proceeding with an action for unfair claims practices under § 624.155, a plaintiff must allege and prove that the defendant insurer breached the insurance contract." In an unpublished opinion, the trial court's ruling was affirmed by the Florida Second District Court of Appeal. Similarly, in *Schultz v. State Farm Florida Insurance Co.*, the insured brought a bad-faith action arising from a fire loss. During the adjustment of the loss, the parties had a disagreement with regard to the amount to be paid to repair

the residence. The insurer demanded appraisal. During the appeal process the insured filed a Civil Remedy Notice. The insurer tendered some money to the insured during the sixty day cure period and let the appraisal panel determine the total amount of damage. The appraisal panel issued its award and the insurer issued a payment for the entire amount of the appraisal award. After payment was issued by the insurer, the insured filed a bad-faith lawsuit. The insurer filed a motion for summary judgment and argued that the bad-faith action only accrues after the insured has established the insurer breached the insurance contract. The trial court entered summary judgment in favor of the insurer, stating: "[i]n order to prevail on their bad-faith claim, Plaintiffs must allege and prove that Defendant breached the insurance contract at issue." In an unpublished opinion, the trial court's ruling was affirmed by the Florida Second District Court of Appeal.

16. 643 So. 2d 617 (Fla. 1994).

17. 753 So. 2d 1270 (Fla. 2000).

18. *Woodall, et al., v. Travelers Indem. Co.*, 669 So. 2d 1361 (Fla. 1997).

19. *Geico Gen. Ins. Co. v. Graci*, 849 So. 2d 1196 (Fla. 4th DCA 2003):

> The only breach of the contract alleged in the complaint was that "plaintiff has demanded payment under the insurance policy from Geico, but Geico has . . . refused to pay." An insurer's refusal to meet an insured's demand for payment under a policy is not a breach if no payment is then due. Because the policy of insurance was attached to the complaint as an exhibit, it is considered a part of the pleadings. *See*, Fla. R. Civ. P 1.130(b).
>
> * * *
>
> The plain language of the policy affirmatively established, in two significant aspects, that no payment from Geico is presently due under the policy and, thus, the alleged breach is nonexistent.
>
> First, Geico's obligation under the policy is to pay damages for bodily injury caused by accident *which the insured is legally entitled to recover* from the owner or operator of the uninsured auto. The amount which Graci is legally entitled to recover from the tortfeasors has yet to be determined, in fact, her counsel admitted to the trial court, during argument on the motion for change of venue, that the amount was unliquidated. Second, the policy provides that if, as here, there are disputes between an insured and Geico as to liability and damages the insured shall sue the owner or operator of the uninsured auto and Geico to have the issues of legal entitlement and amount of damages determined. The complaint clearly shows that the present suit is to resolve the dispute as to liability and damages in the precise manner provided by the contract for the resolution of such a dispute. It cannot be successfully argued that Geico breached the policy by invoking its explicit provisions.
>
> Despite Graci's allegations that the contract of insurance was breached and that the breach occurred in St. Lucie County, we find those allegations are trumped by the policy language referred to above showing that the alleged breach is not, in fact, a breach at all.
>
> * * *
>
> Although Graci's action against Geico is, indeed, an action on the contract of insurance, it is not an action for a breach of that contract; rather, it is an action filed pursuant to the contract. A cursory examination reveals that it is for the purpose of having a determination made of the amount of compensatory damages, if any, to which Graci is entitled under the policy.
>
> * * *
>
> As you can see, when it comes to describing uninsured motorists law, Florida courts seem challenged.

20. The requirement of a finding of breach of contract was recognized by the Fifth District Court of Appeal in *State Farm Mut. Auto. Ins. Co. v. Brewer*, 940 So. 2d 1284 (Fla. 5th DCA 2006) when it stated, "State Farm is correct that the court erred by allowing Brewer's statutory bad faith claim to proceed without a prior determination of liability and the extent of damages allegedly owed on the insurance contract. FN3 We note that Brewer's statutory bad faith

claim may never ripen. To obtain a determination regarding liability and the extent of damages owed on the insurance contract, Brewer would need to bring an action on the contract, which would likely be precluded by the statute of limitations." *Id*. at 1286, citations omitted.

21. 945 So. 2d 1216 (Fla. 2006).

22. 37 Fla. L. Weekly D1965 (Fla. 4th DCA 2012).

23. *Id.* at *1.

24. There are several unpublished decisions that have rejected the reasoning set forth by the *Trafalgar* Court. See *Huffman v. State Farm Florida Ins. Co.*, Case No. 04-10916 (Fla. 13th Cir., October 13, 2008) (holding that before proceeding with a bad-faith action a plaintiff must allege and prove that the defendant insurer breached the insurance contract), *per curiam affirmed* at 23 So. 3d 117 (Fla. 2d DCA 2009); *Schultz v. State Farm Florida Ins. Co.*, Case No. 06-011954 (Fla. 13th Cir., April 30, 2008)(holding that in order to prevail on a bad-faith claim, the insured must allege and prove breach of contract), *per curiam affirmed* at 7 So. 3d 1108 (Fla. 2d DCA 2009); *Wild Enterprises, Inc. v. Assurance Company of America*, 18 Fla. L. Weekly Supp. 1142a (Fla. 4th Cir. 2011)(holding that a determination in the insured's favor on its breach of contract claim against the insurer is a condition precedent to the bad- faith action); *Pacatte v. State Farm Florida Ins. Co.*, Case No. 09-CA-10974 (Fla. 10th Cir., January 19, 2011)(holding that because the insurer did not breach the insurance contract, the insurer is entitled to final summary judgment on the insured's bad-faith action); *Maranatha Baptist Church v. State Farm Florida Ins. Co.*, Case No. 07-9882-CI-11 (Fla. 6th Cir., May 10, 2010)(granting summary judgment in favor of the insurer due to the failure of resolving the breach of contract action in favor of the insured), *per curiam affirmed* at 64 So. 3d 1271 (Fla. 2d DCA 2011); *Hunt v. State Farm Florida Ins. Co.*, Case No. 10-15456 (Fla. 6th Cir. November 22, 2011)(holding that a bad-faith case was prohibited because no judgment was obtained by the insured against the insurer for breach of contract); *Shafmaster v. State Farm Florida Ins. Co.*, Case No. 08-14354 (Fla. 17th Cir., October 9, 2009); *Ehrich v. State Farm Florida Ins. Co.*, Case No. 07-1264-CA (Fla. 20th Cir., August 5, 2010); and *Martin v. State Farm Florida Ins. Co.*, Case No. 2009-34772-CICI (Fla. 7th Cir., July 7, 2010).

26. Cases decided prior to *Trafalgar* tell us that a formal arbitration is not comparable to an informal appraisal. *Preferred Ins. Co. v. Richard Parks Trucking Co.*, 158 So. 2d 817, 820 (Fla. 2d DCA 1963) (citing 5 Am. Jur. 2d, Arbitration and Award § 3 (1962). Also, cases tell us that "appraisal is not a process to resolve a breach of contract claim or even to determine a coverage dispute. Appraisal is a method of adjusting a claim within the terms of the insurance contract to determine the amount payable for the covered claim." *Hill v. State Farm Florida Ins. Co.*, 35 So. 3d 956, 959 (Fla. 2d DCA 2010). *See also Nationwide Property & Cas. Ins. v. Bobinski*, 776 So. 2d 1047, 1048 (Fla. 5th DCA 2001) and *Federated Nat. Ins. Co. v. Esposito*, 937 So. 2d 199, 201 (Fla. 4th DCA 2006).

26. As of this printing, *Trafalgar* is not yet final. ■

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