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The "Other" Intermediaries: The Increasingly Anachronistic Immunity of Managing General Agents and Independent Claims Adjusters

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THE "OTHER" INTERMEDIARIES: THE INCREASINGLY ANACHRONISTIC IMMUNITY OF MANAGING GENERAL AGENTS AND INDEPENDENT CLAIMS ADJUSTERS

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This article addresses the "other" intermediaries involved in the administration of insurance policies, specifically "downstream" intermediaries, who are engaged in the administration of insurance claims. The focus is on managing general agents, third-party administrators and independent contractor claims adjusters, who perform the nuts-and-bolts tasks of the insurance industry, and are generally less well compensated than commercial insurance brokers. Since these "other" intermediaries are immune from judicial claims by policyholders, they are also less incentivized to perform their duties well. The article argues that, in order to improve the claims process, the "other" intermediaries should be held accountable for their misconduct, at least in tort, or even for "bad faith" in the manner of an insurer. It reviews the benefits of accountability and suggests a workable standard for intermediary liability where an intermediary is potentially liable when a policyholder has alleged negligence or some greater wrongdoing.

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I. INTRODUCTION

As a result of headline-grabbing investigations regarding commissions, the role and conduct of major insurance brokers has received prominent attention in the news[1] and also in the academy.[2] In this Symposium, Professor Daniel Schwarcz continues his scholarly inquiry on

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[1] See, e.g., Ian McDonald, Marsh, Spitzer Settle with $850 Million, An Apology to Clients, WALL ST. J., Feb. 1, 2005, at C1; Monica Langley & Ian McDonald, Marsh Averts Criminal Case with New CEO – Resignation and Shift On Business Model Reflect Pressure of Spitzer Probe, WALL ST. J., Oct. 26, 2004, at A1; Monica Langley & Theo Francis, Policy Matters: Marsh Probe May Be Tip of U.S. Insurance Scandal – As Spitzer Broadens Inquiry Into Bid-Rigging, Rivals Like Aon are Felling Heat, WALL ST. J. EUR., Oct 18, 2004, at A1; Theo Francis, Spitzer Charges Bid Rigging in Insurance - Top Broker, Major Firms Named in Legal Actions;'Trust Me: This Is Day One', WALL ST. J., Oct. 15, 2004, at A1. See also Kulbir Walha & Edward E. Filusch, Eliot Spitzer: A Crusader Against Corporate Malfeasance or a Politically Ambitious Spotlight Hound? A Case Study of Eliot Spitzer and Marsh & McLennan, 18 GEO. J. LEGAL ETHICS 1111 (2004-2005) (concluding that Spitzer's use of the media, although questionable on fairness grounds, violated no rules of attorney professional conduct); Stacy Anderson, Developments in Banking and Financial Law: 2004, 24 ANN. REV. BANKING & FIN. L. 1, 94 (2005) ("New York Goes After the Insurance Industry"). Former Attorney General and Governor Spitzer's assessment of the practice of undisclosed contingent commissions is reflected in the title of a press release. See Press Release, Office of New York State Attorney General Eliot Spitzer, Investigation reveals Widespread Corruption in Insurance Industry (Oct. 14, 2004), available at http://www.oag.state.ny.us/media_center/2004/oct/oct14a_04.html. Ironically, Spitzer later would resign the governorship in disgrace after an embarrassing tryst with a very expensive prostitute that raised the prospect, later dropped, of criminal prosecution. See Tom Precious, No Charges for Spitzer in Probe of Prostitution; Federal Prosecutors Conclude Investigation, BUFF. NEWS, Nov. 7, 2008, at A1; Michael M. Grynbaum, Spitzer Resigns as N.Y. Governor; Fierce Enforcer of Ethics is Brought Down by Sex Scandal, INT'L HERALD TRIB., Mar. 13, 2008, at 1.

[2] *See, e.g.*, Sean Fitzpatrick, *The Small Laws: Eliot Spitzer and the Way to Insurance Market Reform*, 74 FORDHAM L. REV. 3041 (2006); J. David Cummins & Neil A. Doherty, *The Economics of Insurance Intermediaries*, 73 J. RISK & INS. 359 (2006). For a pre-Spitzer scholarly examination of the issue, *see* Laureen Regan & Sharon Tennyson, *Agent Discretion and the Choice of Insurance Marketing System*, 39 J.L. & ECON. 637 (1996).

this topic,[3] continuing to make common sense regarding the limits of permissible broker compensation and the wisdom of regulation of broker commissions. His suggestion in this symposium, that hidden or contingent commissions are more of a problem for consumer insurance than for commercial insurance, seems to me unassailable.[4] As Schwarcz argues persuasively, the problems presented by undisclosed contingent commissions in the world of commercial insurance brokerage are magnified in the context of consumer insurance purchases. Defenders of commercial brokerage contingent commissions have generally had the weaker of the argument in general. Applied to consumer insurance purchases, the defenses-cum-apologies for traditional contingent commissions seem even more wanting.

Reviewing the law of insurance intermediary liability, Professor Hazel Beh concludes "that courts frequently impose a relatively low standard of care toward insureds upon intermediaries."[5] She also finds that "traditional principles of agency law do not provide a particularly helpful framework to understand the legal relationships among insured, insurer, and their intermediaries because the intermediary's role is inconstant."[6] The insurance intermediary is a different type of agent, one that not only is the assigned arm of a primary principal but also has duties to another party to the transaction and is subject to public interest considerations generally surrounding the insurance industry.

Rather than echoing Professor Schwarcz's compelling critique of the pitfalls of traditional broker compensation or Professor Beh's insight regarding the limits of traditional agency law as applied to insurance intermediaries, this article addresses the seemingly overlooked "other" intermediaries involved in the administration of insurance policies. Rather than focusing on the "upstream" intermediaries involved in the sale of insurance policies, this article concentrates on "downstream" intermediaries involved in the administration of insurance claims. In

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[3] *See* Daniel Schwarcz, Beyond Disclosure: The Case for Banning Contingent Commissions, 25 YALE L. & POL'Y REV. 289 (2007).

[4] *See* Daniel Schwarcz, Differential Compensation and the "Race to the Bottom" in Consumer Insurance Markets, 15 CONN. INS. L.J. (forthcoming 2009).

[5] *See* Hazel Beh, *Insurance Intermediaries*, 15 CONN. INS. L.J. (forthcoming 2009).

[6] *See id.*

particular, it addresses the question of whether "downstream" insurance intermediaries should be responsible to policyholders and third parties for errors in claims handling. The primary focus is upon managing general agents ("MGAs"), third-party administrators ("TPAs") and independent contractor claims adjusters, rather than the legal and medical professionals that could also be characterized as downstream intermediaries in the relationship between policyholders and insurers. This article also touches upon the law's treatment of other actors commonly involved in the claims process as a useful guide to determining the proper legal governance and liability exposure of MGAs, TPAs and adjusters.

As compared to MGAs, TPAs and independent claims adjusters, commercial insurance brokers, the primary focus of recent scholarship on intermediaries, are the "sexy," "Hollywood" intermediaries of the insurance business. Figuratively, at least, they eat at the Four Seasons and are fixtures at the industry's golf outings in Bermuda or other resort destinations, as they schmooze with clients and insurers in search of policy sales. For their efforts, brokers, like Marsh and Aon, are well compensated, often paid six figures in annual base pay for representing a policyholder in search of insurance, as well as typically receiving long-standing (but now occasionally controversial) commissions based on the insurance products they procure for their large, wealthy, prestigious business clients.

In contrast, MGAs, TPAs and independent adjusters are saddled with the decidedly less festive task of underwriting (sometimes), billing, record-keeping, and claims processing: ensuring that the insurance policies for which the brokers have already been well paid are properly administered. In return for shouldering these nuts-and-bolts tasks and potentially alienating policyholders through claims denial or mishandling, these other intermediaries are generally less well compensated, particularly as respects claims adjusting. They are more likely to be wolfing down a Big Mac in the office or on the way to an appointment then lunching in the finer restaurants of a major city.

The comparatively low-budget drudgery of these other intermediaries unfairly masks their importance to the insurance system. Many insurers have "outsourced" substantial parts of their operations, making MGAs, TPAs and independent adjusters de facto insurers, at least for purposes of these key tasks related to policy administration and claims handling. Despite their increasing importance, these intermediaries have historically been immune from claims by disgruntled policyholders (or others, including claimants) so long as the insurer for whom they work is known to the policyholder or there is no formal written contract between the downstream intermediary and the policyholder or other third party.

As a result, these intermediaries have been effectively beyond the reach of judicial regulation while being simultaneously under-regulated by executive branch insurance departments. Faced with reduced incentive to discharge their duties well, the other intermediaries frequently act negligently, recklessly, or even in bad faith, needlessly creating claims imbroglios that could be avoided, minimized, or streamlined.

In the past, legal reluctance to hold these other intermediaries responsible for errors may have been tolerable or even efficient. Today, however, the greater near-autonomous role now shouldered by MGAs, TPAs and independent adjusters demands that they be treated under the law on a par with the insurers they represent. Instead of essentially being immunized from the consequences of their errors, these intermediaries should be held accountable, at least in tort for misconduct even if not for "bad faith" in the manner of an insurer.[7] Holding these intermediaries more accountable holds at least some promise for improvement of the claims process.

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[7] *See Largest MGAs/underwriting managers*, BUS. INS., Sept. 8, 2008, at 20 (ranking of MGAs shows ten largest to have 2007 premium volume of more than $5 billion, reflecting the degree to which these intermediaries have become big business.) This article does not address questions of the duties and liabilities owed by "front end" insurance intermediaries generally but instead addressed the "back end" or "downstream" (my preferred term) intermediaries involved in policy administration and claims. *See id.* As noted above, the issue of the degree to which brokers or sales agents may be liable to insurers, policyholders, or others and the standard of care applicable to these "upstream" intermediaries lies beyond the scope of this article. *Id.* In general, both brokers and agents may be independently liable to insurance applicants and policyholders for negligence or misconduct in the performance of their duties even when their actions are not binding on their principals. *See, e.g.*, Terrain Tamers Chip Hauling, Inc. v. Ins. Mktg. Corp. of Oregon, 152 P.3d 915, 918 (Or. Ct. App. 2007) (settlement with insurer does not extinguish policyholder's claim against agent). *But see* Bentley v. North Carolina Ins. Guar. Ass'n, 418 S.E.2d 705, 712-713 (N.C. Ct. App. 1992) (policyholder cannot bring bad faith claim against insurance sales agent because of lack of privity of contract). *See also* Londo v. McLaughlin, 587 A.2d 744, 748 (Pa. Super. Ct. 1991) (by statute, brokers owe duty of good faith to policyholder clients).

II. THE TRADITIONAL DOCTRINE OF INTERMEDIARY IMMUNITY

Just as insurance law is a subset of contract law, the law of insurance intermediary liability is a subset of agency law. The principal is the insurer that hires a downstream agent (the intermediary) to represent it in the administration of the policies it has sold. The agent in turn interacts with the principal's "customers" or policyholders and also represents the insurer in dealing with third parties who make liability claims against the policyholder. A "hornbook" rule of agency law, most authoritatively stated in § 320 of the American Law Institute's RESTATEMENT (SECOND) OF AGENCY and continued in § 6.01 of the RESTATEMENT (THIRD) OF AGENCY, is that an agent for a "disclosed" principal is not itself liable for any acts of the principal.[8]

The law of insurance intermediaries, like insurance itself, is also a subset of contract law. To enjoy contract rights, one must normally have entered into a contract with the entity from which one seeks contract rights. Unless one was in "privity" of contract with the party from which relief is sought, the claimant would ordinarily be barred from relief by the historical

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[8] *See* RESTATEMENT (SECOND) OF AGENCY § 320 (1958) ("Unless otherwise agreed, a person making or purporting to make a contract with another as agent for a disclosed principal does not become a party to the contract."); RESTATEMENT (THIRD) OF AGENCY § 6.01 (2006) ("When an agent acting with actual or apparent authority makes a contract on behalf of a disclosed principal, (1) the principal and the third party are parties to the contract; and (2) the agent is not a party to the contract unless the agent and third party agree otherwise."). *See also* 3 C.J.S. *Agency* § 485 (2008) (Ordinarily where the agency is disclosed, a plaintiff entitled to recover is entitled to recover against the principal but not the agent); 2A C.J.S. *Agency* § 365 (2008) (An agent who contracts on behalf of a disclosed principal and within the scope of his authority, in the absence of an agreement to the contrary, or other circumstances showing that he has expressly or impliedly incurred or intended to incur personal responsibility, is not personally liable to the other contracting party, although he may execute the contract in a manner which would otherwise bind him personally, and he need not expressly negate his liability); 12-88 APPLEMAN ON INSURANCE § 88.5 (2d ed. 1996 & Supp. 2008). Because the RESTATEMENT (THIRD) is so recent, the limited case law invoking agency principles to shield insurance intermediaries has been based on the RESTATEMENT (SECOND). At this juncture, RESTATEMENT (THIRD) § 6.01 has been cited by only a handful of courts, with none of the decisions involving liability of insurance intermediaries.

"citadel" of privity of contract, which held that an entity not in contractual privity owed no contract-based duties to an aggrieved party and generally owed no socially imposed tort duties as well.[9] Although recovery could be premised on a theory that the claimant was a third-party beneficiary of the contract between agent and principal, courts were historically reluctant to give contract rights to any third-party beneficiary not specifically so identified in a written instrument.[10]

These hornbook rules became established during the 19th Century as Anglo-American law grappled with the question of the apt extent of liability in a growing, increasingly industrial society. The courts largely accepted, at least implicitly, the proposition that unduly broad imposition of liability would throw too much sand in the metaphorical gears of progress and exact too high a tax on commercial activity. Where a

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[9] *See* Dan B. Dobbs, The Law of Torts § 353 (2000); William S. Prosser, Hornbook of the Law of Torts §§ 93, 96-104 (4th ed. 1971). *See also* Lee R. Russ with Thomas F. Segalla, Couch on Insurance § 208:10 (3d ed. & Supp. 2008):

> Although there are exceptions, investigators and adjusters working under contract for the insurer are, for the most part, not considered to have sufficient privity with or duty to the insured to be directly and personally liable to the insured. Insureds have a better chance of surviving preliminary dismissal motions by framing their actions as breaches of duty owed to the public at large---torts of various types. Of these, the most likely sources of an actionable duty involve the investigator or adjuster acting in a way that "interferes" with the insured's relationship with the insurer, or with some other legally protected right of the insured.

For more discussion of basic tort law as a ground for holding claim intermediaries liable to policyholders or claimants, *see infra* text accompanying notes 177-221.

[10] *See* E. ALLAN FARNSWORTH, CONTRACTS § 10.2 (3rd ed. 1999) (historically, third parties generally did not enjoy rights under contract unless contract text expressly indicates that third party was intended beneficiary of contract). *See, e.g.*, Hudock v. Donegal Mut. Ins. Co., 263 A.2d 668, 672 (Pa. 1970) ("Without such a [contractual] relationship, it is impossible for the [independent claims] adjusters to be liable for breach of contract to the insureds.").

commercial actor was linked to another by contract, this created certain rights. But absent such links, law was reluctant to impose liability.[11]

In addition, immunity for the agents of disclosed principals could be defended on the ground that an aggrieved party nonetheless had substantial legal rights as against the principal. Imposing liability on the agent of the disclosed principal thus seemed unnecessary. Under a rough cost-benefit analysis, the tacit notion appears to be that although agent liability would provide an additional source of compensation for the injured, it brought with it a greater burden of discouraging socially useful agency activity and encouraging needless expansion of disputes.[12]

Applied to the typical commercial transactions of the era, the traditional rules of privity and agency immunity made sense, at least initially. Consider a sale of goods by Merchant Marley through Agent Cratchett to Consumer Dickens. If it is clear that Cratchett is selling on behalf of Marley, Dickens knows with whom he deals: a ruthless businessman not above cutting corners (who would have an ethical epiphany only after death) and not the fair, guileless agent.[13] After the sale, if Dickens finds the goods to be substandard, he may sue Marley for relief but generally could not also sue Cratchett, an agent for a disclosed principal who has no contractual privity with Dickens.

Because Cratchett appears not to have had any fault or to have much in the way of autonomy, assets, or insurance (the liability insurance

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[11] *See* sources cited *supra* note 9. *See, e.g.*, Winterbottom v. Wright, (1842) 152 Eng. Rep. 402. *Accord* National Sav. Bank v. Ward, 100 U.S. 195, 203 (1879). But as Prosser also noted, the "citadel" of privity protecting manufacturers and wholesalers not in direct contract with consumers fell during the first half of the 20th Century as courts permitted product liability claims in cases where a product caused physical injury to its ultimate user. *See* PROSSER, *supra* note 9, § 97. By contrast, the privity prerequisite to liability has retained considerable force regarding agency issues outside the context of product liability.

[12] *See infra* text accompanying notes 15-22, 122-149 (discussing this rationale in modern cases rejecting liability claims against insurance intermediaries).

[13] Although Dickens presumably did not know ex ante that Marley would have a posthumous epiphany (in time to save his partner Scrooge), Dickens famously acquired ex post knowledge. *See* CHARLES DICKENS, A CHRISTMAS CAROL (Atlantic Monthly Press) (1843).

industry did not really emerge until after the industrial revolution and was not well-established until the 20th Century)[14] there is not a particularly strong case for permitting him to be sued by Dickens or other dissatisfied customers. Marley is the one responsible for the substandard goods and he should be the one responsible for rectifying things for Dickens. One could argue that making Cratchett liable as well will induce greater care by Cratchett, but this could manifest itself in socially wasteful activity such as Cratchett inspecting the Marley products or standing over the shoulder of Marley's operations.

Further, as a practical matter, agents like Cratchett with little autonomy are not expected to do much more than be conduits for making a sale and to take orders accordingly. He probably would not be permitted to attempt to provide some quality control to Marley's operation but would be summarily fired by Marley for his temerity. As this aspect of the hypothetical illustrates, Cratchett in this case is more like an insurance sales or soliciting agent and quite removed in scope of authority from the modern MGA or adjuster, who may have quite a bit of either express or practical authority about the manner in which a claim is resolved.

If instead of being the sales agent, Cratchett were the Complaint Department at Scrooge & Marley, his situation would be closer to that found in modern insurance, at least if Marley had delegated significant authority to Cratchett. In addition, law has subsequently moved substantially in the direction of holding front-end intermediaries such as insurance agents liable under some circumstances, such as when the agent knows of a particular customer's coverage needs and then procures an inappropriate policy or fails to follow through on a promised purchase.[15]

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[14] *See* JOHN FABIAN WITT, THE ACCIDENTAL REPUBLIC: CRIPPLED WORKMEN, DESTITUTE WIDOWS, AND THE REMAKING OF AMERICAN LAW (2004) (describing the rise of accident and liability insurance in reaction to increase in injuries associated with industrial revolution); John Fabian Witt, *The Transformation of Work and the Law of Workplace Accidents, 1842-1910*, 107 YALE L.J. 1467 (1997-1998) (also describing the rise of accident and liability insurance in reaction to increase in injuries associated with industrial revolution).

[15] *See* ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW § 35 (3d ed. 2002); ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 2.5 (1988). *See, e.g.*, President v. Jenkins, 853 A.2d 247 (N.J. 2004) (no duty to advise applicant doctor about gap in coverage where doctor did not advise broker about lapse of prior policy); Canales v. Wilson Southland Ins. Agency, 583 S.E.2d 203 (Ga. Ct. App. 2003) (no duty to advise policyholder that auto policy provided no coverage

Consequently, the historical immunity of agents for disclosed principles has begun to look outdated.

When Dickens makes the purchase, there is of course the danger that Marley, a notoriously mean character, will only make good on the contract if sued to judgment or that he might seek to avoid his lawful debts. But Dickens knew he was dealing with Marley and historically was constructively charged with knowing these things about his infamous vender. In addition, the law of debt relief was considerably less favorable to the Marleys of the world at the time that the general rule was crafted. Rather than risk debtor's prison, Marley was likely to pay a court judgment obtained by Dickens. Secreting assets was more difficult as well in a world predating electronic funds transfer, sophisticated corporate shells, and cooperative tropical havens for capital.[16]

Under the traditional rules protecting agents, if an insurance policyholder or third party claimant knows that the MGA, TPA, or adjuster is working for the insurer, the MGA, TPA or independent contractor adjuster is generally not itself liable for any misconduct that injures the policyholder or the claimant. The identity of the insurer as principal is almost always disclosed in that the policyholder of course knows that it has insurance with a particular company/principal and the claimant is usually made aware of this by the MGA/adjuster. As a result, under the traditional agency law analysis, MGAs, TPAs and independent adjusters were not held

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outside U.S. and Canada). The broker's limited exposure is something of a two-way street. *See, e.g.*, DeHayes Group v. Pretzels, Inc., 786 N.E.2d 779 (Ind. Ct. App. 2003) (insurer lacked special relationship with broker sufficient to require broker to advise insurer that policyholder sprinkler system was inadequate to suppress fire). The agent's potential liability exposure often hinges on the specific facts of a case. *See, e.g.* Harris v. Albrecht, 86 P.3d 728 (Utah 2006) (agent not liable for failing to procure policy where evidence shows that possibility of additional insurance was discussed but policyholder never directed agent to procure insurance); Murphy v. Kuhn, 682 N.E.2d 972 (N.Y. 1997) (insufficient "special relationship" between agent and customer to make agent liable for alleged failure to advise customer regarding "possible additional insurance coverage needs."). Where an agent sells or distributes a merchant's dangerous products, the law long ago removed the shield of contractual privity as a defense to product liability claims. *See infra* text accompanying notes 43-46.

[16] *See* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996-1997).

liable for mishandling of claims, even when their misconduct amounted to bad faith toward a policyholder.[17]

Case law concerning this issue is almost uniformly favorable to insurance intermediaries until the late 20th Century. Where an independent claims adjuster or administrator is accused of mistreating a policyholder or otherwise causing injury, the comparatively few reported cases find the intermediary immunized as a matter of law so long as its representation of the insurer was adequately disclosed.[18] That the cases are so few in number suggest that most aggrieved policyholders or claimants may not have even considered a claim against the intermediary or that such claims were quickly dismissed at the trial level and never challenged on appeal.

Ironically, comparatively few of these cases specifically cite *Agency Restatement* § 320.[19] More commonly, decision is based on the absence of contractual privity between the intermediary and the policyholder or claimant,[20] although agency concepts are also occasionally

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[17] *See, e.g.*, Egan v. Mutual of Omaha Ins. Co., 620 P.2d 141 (Cal. 1979); Larkin v. First of Georgia Underwriters, 466 So.2d 655 (La. Ct. App. 1985).

[18] *See, e.g.*, Gruenberg v. Aetna Ins. Co., 510 P.2d 1032 (Cal. 1973) (defendants other than insurers not liable for alleged bad faith conduct toward policyholder, resulting in dismissal of investigative service hired by insurers, claims adjuster employed by service, law firm representing insurers in claims adjustment, and individual lawyer in firm). "Obviously, the non-insurer defendants were not parties to the agreements for insurance; therefore, they are not, as such, subject to an implied duty of good faith and fair dealing." *Id.* at 576.

[19] An October 2008 search of the LexisNexis federal and state court database yields fewer than 40 cases citing RESTATEMENT (SECOND) OF AGENCY § 320 (1958) in cases even tangentially involving insurers. Fewer than 15 cases expressly cited § 320 and address the issue of the liability of an intermediary, including both "upstream" sales intermediaries and "downstream" policy administration intermediaries.

[20] *See, e.g.*, Wolverton v. Bullock, 35 F. Supp. 2d 1278, 1281 (auto policyholder cannot sue independent claims adjuster because "in the absence of a contract between Sentry [adjuster] and Bullock [policyholder], there can be no implied duty of good faith that Sentry would have owed Bullock. This holding is consistent with approaches taken in other jurisdictions.") (citing cases from Alabama, California, Louisiana, Nevada, Oklahoma, Mississippi, and Pennsylvania as well as Kansas); Wathor v. Mut. Assur. Adm'rs, 87 P.3d 559, 562 (Okla. 2004) (TPA owes no duty of good faith and fair dealing to policyholders

invoked,[21] sometimes without a specific citation to § 320.[22] Little consideration is given to the issue of whether the overall context of the

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and facts of the case do not permit policyholders to recover against TPA as third-party beneficiaries of contracts between TPA and an insurer); Natividad v. Alexsis, Inc., 875 S.W.2d 695, 698 (Tex. 1994) (holding no adjuster duty of good faith and fair dealing and no special relationship with policyholder absent contract); Amica Mut. Ins. Co. v. Schettler, 768 P.2d 950, 957-58 (Utah 1989) (holding there is no adjuster duty of good faith and fair dealing and no special relationship with a policy holder absent a contract); Scribner v. AIU Ins. Co., 647 A.2d 48, 50-51 (Conn. Super. Ct. 1994) ("Although Connecticut recognizes a common law duty of an insurer to act in good faith in the settlement of the claims of its insured, a cause of action for breach of that duty may be asserted only against an insurers. An action for bad faith, therefore, does not lie against a person who is not a party to the contract of insurance, including an attorney.") (citations omitted); Larkin v. First of Georgia Underwriters, 466 So.2d 655, 657 (La. Ct. App. 1985) (holding a homeowner/policyholder alleging breach of contract and bad faith cannot sue independent claims adjuster because no privity of contract between homeowner and adjuster).

In occasional twists of irony, the traditional approach may on occasion prevent insurers from obtaining relief against intermediaries. For example, in *Farmers Alliance Mut. Ins. Co. v. Naylor*, 452 F. Supp. 2d 1167 (D. N.M. 2006), an insurer facing a presumably questionable claim when fire destroyed a furniture store hired an investigator and independent engineer to conduct a cause-and-origin examination of the fire. When these individuals allegedly failed to preserve evidence useful to the insurer's defense (presumably one based on arson), the insurer sought to hold each personally liable. The individual investigator sought dismissal on the ground that the insurer's contract was with his employer, an investigation company, and that the insurer had no claim against him. The court agreed, even though the company was a company he had founded and controlled. *See* 452 F. Supp. 2d at 1175-76 (citing RESTATEMENT § 320, as well as noting absence of direct contract between individual investigator and insurer). *See also* First Specialty Ins. Corp. v. NovaPro Risk Solutions, Inc., 468 F. Supp.2d 1321, 1343 (D.Kan. 2007), *see infra* notes 161-176 and accompanying text.

21 *See, e.g.*, LaFontaine v. Mass. Cas. Co., No. C05-5059FDB, 2006 U.S. Dist. LEXIS 27137 at *7 (W.D. Wash., April 27, 2006), *aff'd in part, rev'd in part on other grounds*, No. 06-35434, 2007 U.S. App. LEXIS 26392 (9th Cir. Nov. 9, 2007) (independent claims adjuster for disability insurer initially sued by insured, but dropped from the case by mutual consent when defendant adjuster and insurer argued that adjuster was "a disclosed agent of Massachusetts Casualty Insurance Company [because] Washington follows the RESTATEMENT (SECOND) OF AGENCY § 320 (1958)") (citing Hopkins v. Anderson, 766, 502 P.2d 473 (Wash. Ct. App. 1972)); Am. Ins. Co. v Material Transit, Inc., 446 A.2d 1101, 1105 (Del. Sup. Ct.,

1982) (holding an agent processing insurance premium payments that erroneously misapplied funds resulting in wrongful cancellation of policy not itself liable because it acted as agent for disclosed principal and had no contractual relationship with policyholder).

> [I]n making these payment arrangements [payment processor] Montgomery was not acting for itself but was solely acting as the agent of American Insurance. It is established law that an agent for a disclosed principal is not a party to a contract and is not liable for its nonperformance. *Restatement (Second) Agency* §§ 320, 328; 16 Appleman, *Insurance Law and Practice* § 8832 at 459 (1968). Thus, the only parties to this allegedly breached payment contract are American Insurance [insurer] and Material Transit [policyholder]. Montgomery, acting as agent on behalf of a disclosed principal, American Insurance, is not personally liable to third-party, Material Transit, for acts performed within the scope of its authority.

Id. at 1104-105.

See also WESTRM-West Risk Markets, Ltd. v. XL Reinsurance America, Inc., 02 Civ. 7344 (MGC), 2006 U.S. Dist. LEXIS 48769, at *17-*18 (S.D.N.Y., July 19, 2006) (dismissing claim against issuing agent on contract and agency grounds); Seigworth v. State, 539 P.2d 464, 466 (Nev. 1975) (holding an individual agent for bail bond company is not liable for bond forfeiture when criminal accused fails to show up for court date). Of course, the agency at issue in *Seigworth* is one of upstream sales agency rather than insurance policy (and a bail bond is an insurance policy or surety arrangement and thus falls outside the scope of this article). However, the short-and-sweet resolution of the question provides a good example of the traditional rule in action.

> [W]e now turn to the question, is a bail agent, as attorney-in-fact for the purpose of binding the insurer, himself a surety for the appearance bond?
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> Unless otherwise agreed, a person making or purporting to make a contract with another as agent for a disclosed principal does not become a party to the contract. *Restatement, Second, Agency* § 320. See also, Restatement § 4(1), Restatement § 4, Comment (a) and Restatement §328.
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> [In this case,] Resolute Insurance Company is a disclosed principal; Drendel, dba Mac's Bail Bonds is an agent. Drendel cannot be liable for the bond forfeiture.

Id. at 466.

In *WEST-RM*, another case technically involving more of an upstream agency problem than one of policy administration, the federal district court was almost as succinct in applying the traditional rule but held out some ground for possible liability in the future depending on agent activity.

situation creates a relationship for which the law should apply tort law duties of reasonable care.

In addition to fighting this general rule of agent immunity, third party claimants had the additional barrier of the legal rule that an insurer's misconduct in claims administration generally does not create a direct cause of action for the claimant due to the absence of privity of contract and a public policy reluctance to allow such direct actions because of the nature of liability claims in which the insurer is usually charged with

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> [T]he settled rule in New York is that "when an agent makes a contract for a disclosed principal, it becomes neither a party to the contract nor liable for the performance of the contract. Accordingly, it is not liable if the contract is breached." *Seguros Banvenez, S.A. v. S/S Oliver Drescher*, 761 F.2d 855, 850 (2d Cir. 1985)(citing RESTATEMENT (SECOND) OF AGENCY §§ 320, 328). Although an agent might be held liable on a contract if he acted outside the scope of his agency in executing the contract, [there is no evidence that this occurred and no evidence that the intermediary was subject to the indemnity provisions of the surety bonds in question].

WESTRM-West Risk Markets, Ltd., 2006 U.S. Dist. LEXIS 48769 at *17-*18 (emphasis in original).

[22] *See, e.g.*, Gorab v. Equity Gen. Agents, Inc., 661 P.2d 1196 (Colo. App. 1983), in which the Court affirmed a dismissal of a claim against an independent insurance sales agent, but found that its principal, California Union Insurance, could be sued for negligent failure to settle.

> Central to the plaintiff's right to recover on these [negligence and breach of contract] claims is the contractual relationship arising from the Cal Union errors and omissions policy. [citation omitted] Since Equity General is the agent of Cal Union, and is not a party to the contract of insurance, it is not bound by duties created under the contract. Accordingly, liability for breach of those duties, whether the breach be contractual or tortuous in nature, cannot be visited upon the agent.

Id. at 1198 (citing Egan v. Mut. of Omaha Inc., 620 P.2d 141 (Cal. 1979) and Iversen v. Superior Court, 127 Cal. Rptr. 49 (Cal. Ct. App. 1976)). The Colorado Supreme Court subsequently rejected this approach and made adjusters potentially liable for negligent failure to settle in *Cary v. United of Omaha Life Ins.*, 68 P.3d 462 (Colo. 2003). During the intervening 20 years, Colorado caselaw had been edging away from the pure historical rule of agent and intermediary liability set forth in *Gorab*.

defending the policyholder and questioning as necessary the merits of the claim.[23]

Bad faith scholar Stephen Ashley adds an additional historical perspective on the manner in which the requirement of contractual privity has insulated insurance intermediaries. In his view, part of the problem is that basing the existence of a bad faith cause of action on a contract's implied covenant of good faith and fair dealing, which was the fulcrum of the modern spurt in first-party bad faith law emerging from California Supreme Court caselaw of the 1970s, resulted in obsessive judicial focus on a formal contractual relationship and privity of contract between the party seeking relief and the actor alleged to have committed misconduct.[24]

In particular, Ashley views the source of the problem as *Gruenberg v. Aetna Ins. Co.*,[25] which he describes as "the landmark case" recognizing "a cause of action for bad faith in first-party cases."[26] *Gruenberg* found that a first-party policyholder (in this case one involving life/health insurance) had bad faith rights vis-à-vis the insurer, which was at the time a novel view, even though bad faith rights of third party liability insurance policyholders had been recognized for several decades.[27] However, the

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[23] *See, e.g.*, Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58, 61 (Cal. 1988).

[24] *See* Stephen S. Ashley, Bad Faith Actions: Liability and Damages §§ 6:09, 6:15 (2d ed. 1997).

[25] 510 P.2d 1032 (Cal. 1973).

[26] ASHLEY, *supra* note 24, at 6:15. California also launched the modern era of bad faith in the third-party liability context with cases like *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 202 (Cal. 1958) and *Crisci v. Sec. Ins. Co.*, 426 P.2d 173, 176 (Cal. 1967). But the widespread emergence of bad faith actions in the first party insurance context did not occur until the 1970s and 1980s. *See also* Seth William Goren, *Looking for Law in All the Wrong Places: Problems in Applying the Implied Covenant of Good Faith Performance*, 37 U.S.F. L. REV. 257, 268 (2002)(referring to *Comunale* as a "benchmark case").

[27] *See, e.g.*, Hilker v. W. Auto. Ins. Co., 231 N.W. 257, 258-59 (Wis. 1930); *reaff'd on reh'g*, Hilker v. W. Auto. Ins. Co., 235 N.W. 413 (Wis. 1931); Douglas v. U.S. Fid. & Guar. Co., 127 A. 708, 709 (1924). *See generally* JEFFREY W. STEMPEL, STEMPEL ON INSURANCE CONTRACTS Ch. 10 (3d ed. 2006 & Supp. 2009).

The ability of a liability policyholder to sue for bad faith was recognized much earlier than any similar right for first-party policyholders largely because courts viewed the liability policyholder as considerably more vulnerable and dependent upon the insurer since the insurer was controlling the defense of any third-party claims against the policyholder. In particular, courts have seen the insurer and policyholder as part of a defense "team" involving mutual obligations of protection and cooperation, while viewing first-party insurance as something closer to a pure arms-length commercial contract where either party is free to take advantage of the other (although this odd view has fortunately eroded over the past 30 years).

Further, liability claims have the potential to greatly exceed the amount of available insurance if settlement of the claim is not reached and expose the policyholder to potentially bankrupting liability. By contrast, first-part insurance is, at least in theory, supposed to be available in amounts sufficient to provide adequate indemnity once any bad faith wrongs of the insurer have been righted. For example, a homeowner's policy is likely to be more in sync with property value than may be the case when comparing auto liability policy limits and a serious auto injury claim.

However, the path to modern bad faith law was not necessarily linear or smooth. *Hilker*, cited above, is often viewed as the seminal case of what might be called the early modern era in which liability insurers charged with defending claims against policyholders were held to reasonably rigorous standards of conduct toward policyholders. Prior to *Hilker*, many cases had stated generally that an insurer may not act in bad faith, but, when examined closely, these cases tended to define bad faith as an actual, specific intent to harm the policyholder or outright fraud. This is a more constrained view of bad faith than found in modern cases, which find bad faith where an insurer's conduct has been non-malicious but unreasonable, insufficiently solicitous of the policyholder's interests (as opposed to the insurer's interests) or otherwise deprived the policyholder of the benefit of the bargain embodied by the insurance policy.

For example, in *Best Bldg. Co., v. Employers' Liab. Assur. Corp.*, 160 N.E. 911 (N.Y. 1928), the court observed:

> [t]hat the insurance company in the handling of the litigation or in failing to settle is liable for its fraud or bad faith is conceded and has been repeatedly stated in all the cases bearing on the subject. So also it has been held by this court that the company is not liable on its contract for a failure to settle; a contract imposes upon it no such duty.
> [T]here is no implied obligation in the insurance policy in this case that the company must or will settle according to the offer made. * * * The insurance company, in refusing to settle the actions, did what it had the legal right to do under the terms of the policy."

Id. at 912.

In other words, on the eve of the *Hilker* decision, the bad faith law of New York and most other jurisdictions were relatively toothless in that it did not include the now familiar "duty to settle," which is not literally a duty to settle under any circumstances and throw money at even frivolous claims, but instead requires that an insurer accept a reasonable settlement offer at or below the available policy limits in cases where there is a substantial risk of an excess verdict that would put the policyholder's own assets at risk. A significant exception is Texas, which established a duty to settle in *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544, 547-48 (Tex. Comm. App. 1929). Today, the duty to settle in Texas is still routinely labeled the insurer's "*Stowers* duty."

The facts of *Best Bldg. v. Employers' Liab.* created a situation ripe for declaring the existence of a duty to settle, but the New York Court of Appeals showed no interest. An employee was injured and made a claim. The liability insurer, which had a $10,000 policy limit, defended the claim. The plaintiff offered to settle for $8,500; the insurer counter-offered at $6,500 and did not inform the policyholder of the offer or counter-offer. Trial resulted in a judgment of $16,000 for the injured plaintiff, leaving the employer policyholder understandably upset that it faced $6,000 of its own liability. Further, the policyholder alleged that it was willing to contribute up to $2,000 of its own funds to resolve the matter and therefore could have worked with the insurer to effect a settlement had it merely been informed of the offer and counter-offer.

Despite these sympathetic facts, the Court was unmoved, viewing the insurer as having unfettered contract rights to settle or try the case as it saw fit regardless of the consequences to the policyholder. The Court dismissed the bad faith claim as a matter of law. It was not even willing to permit fact-finding and trial regarding the circumstances of the insurer's seemingly obvious error in failing to resolve a case that resulted in a 160% excess verdict. As long as the failure to settle resulted from mere negligence rather than intent to disserve the policyholder, the insurer was unregulated in this regard, a situation quite different than the norms of modern insurance bad faith law.

By contrast, the Wisconsin Supreme Court in *Hilker* found the negligently unreasonable behavior by the insurer could support bad faith failure to settle claims. The insurer had rejected the injured plaintiff's settlement offer and responded only with a low offer.

The adjuster for the company exhibited an indifferent and hostile attitude, refusing to meet and discuss settlement in the offices of the attorneys representing the [plaintiff] girl and her father.

[The adjuster and defense counsel] must have known that the testimony of these eye-witnesses of the accident tended to establish actionable negligence on the part of the [defendant and] that the injury was one for which a verdict might be rendered for a sum much in excess of the coverage of the policy. They knew that they had absolute control of the litigation and of its adjustment. They also knew that plaintiff would be liable for all sums in excess of $5,000 which might be

Gruenberg Court refused to recognize any bad faith cause of action against the independent adjuster involved in the case or the law firm representing the insurer.

> Obviously, the non-insurer defendants were not parties to the agreements for insurance; therefore, they are not, as such, subject to an implied duty of good faith and fair dealing. Moreover, as agents and employees of the

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recovered in these actions. Under such circumstances the failure to make some more effective effort to adjust the cases does present evidence which sustains the finding that the defendant acted in bad faith toward the plaintiff in handling these claims and conducting this litigation. *Hilker*, 231 N.W. at 260.

As the quotation above might suggest, the first *Hilker* decision left some uncertainty as to whether the insurer's errors amounting to bad faith were negligent or intentional, leading counsel to seek rehearing to clarify the legal standard to be derived from the case. After rehearing and decision a year later, the Court made clear that the insurer's settlement failures need not be willfully intended to injure the policyholder in order to be actionable as bad faith.

[Although it] is the right of the insurer to exercise its own judgment upon the question of whether the claim should be settled or contested . . . the decision should be an honest and intelligent one. . . . . In order to be honest and intelligent it must be based upon a knowledge of the facts and circumstances upon which liability is predicated upon a knowledge of the nature and extent of the injuries so far as they reasonably can be ascertained.

This requires the insurance company to make a diligent effort to ascertain the facts upon which only an intelligent and good-faith judgment may be predicated. * * * [I]t should exercise reasonable diligence in this behalf, which means such diligence as the great majority of persons use in the same or similar circumstances. This is ordinary care. *Hilker II*, 235 N.W. at 414-15.

The modern era had arrived regarding duty-to-settle/failure-to-settle bad duties imposed upon liability insurers and it in essence required insurers not to be negligent in their investigation, defense, and settlement conduct regarding a claim against the policyholder. Over the ensuing four decades, third-party bad faith law became more favorable to policyholders in that it generally came to hold that the insurer failing to settle was automatically responsible for the amount of the excess verdict, and also permitted policyholders to seek punitive damages where the insurer's failure to settle went beyond negligence and exhibited willful indifference to policyholder rights. *See* STEMPEL ON INSURANCE CONTRACTS, *supra*, § 10.06. However, it was not until the 1970s that there was significant recognition of a bad faith cause of action for first-party policyholders faced with unreasonable insurer claims adjustment.

> defendant insurers, they cannot be held accountable on a theory of conspiracy.[28]

To Ashley, the focus on contract as the source of rights to demand reasonable insurer behavior was something of a wrong turn in the law, even though California (in *Gruenberg* and other decisions) and most other states treat breach of the covenant of good faith as a tort, which can subject at least the insurer to a range of compensatory damages as well as punitive damages, at least if it is the policyholder or its proper assignee that is suing the insurer. As Ashley points out, claimants injured by the policyholder seldom have a direct right of action against the insurer that acts in bad faith, a limitation in the law he regards as related to limits on the policyholder's ability to bring bad faith claims against independent adjusters and MGAs.[29]

My own view is in some disagreement with Ashley in that I see nothing wrong with the basic analysis that has led to the modern establishment of the tort of insurance bad faith in actions by policyholders against insurers. These parties have a contract. The insurance policy contract, like all contracts, carries with it an implied covenant of good faith and fair dealing. But unlike most consumer and commercial contracts, the insurance arrangement and the relationship of insurer and policyholder establish a context in which the meaning of good faith changes (from mere "honesty in fact" to a requirement of reasonable behavior giving equal consideration to the interests of the policyholder) and the covenant of good faith creates tort duties imposed by law on the insurer. The breach of the covenant and those duties correspondingly subjects the insurer that acts in bad faith to tort law damages, including punitive damages if the

[28] 510 P.2d at 1039 (quoted in ASHLEY, *supra* note 24, § 6:15).

[29] *See* ASHLEY, *supra* note 24, § 6:15 (*Gruenberg* approach of "reliance on the implied covenant of good faith and fair dealing as the foundation for the tort of bad faith has posed problems for the California courts in determining which persons harmed by an insurer's unreasonable rejection of a claim may sue the insurer for bad faith. The same problems have plagued the courts' efforts to determine which persons responsible for the insurer's unreasonable conduct may be sued for bad faith."). *See also* Francis J. Mootz, III, *The Sounds of Silence: Waiting for Courts to Acknowledge That Public Policy Justifies Awarding Damages to Third-Party Claimants When Liability Insurers Deal With Them in Bad Faith,* 2 NEV. L.J. 443, 443 (2002) (arguing in favor of third-party claimant standing to bring bad faith actions against insurer that breaches duty to policyholder to defend/settle claim).

unreasonable behavior is accompanied by a willful indifference to the rights of the policyholder.

This is not a bad syllogism or analysis and provides a sound basis for holding both liability insurers and first-party insurers (property, life, health, disability) liable to policyholders for bad faith breach. Ashley, however, seems to suggest it is an imperfect or even defective analysis because it does not automatically establish standing to sue for bad faith for the third-party complainants themselves or for actions against the downstream intermediaries that administer insurance policies.

From my perspective, Ashley's lament is only partially well-taken. Requiring a sufficiently significant, not-too-attenuated contract connection as prerequisite for bad faith liability makes sense. Failing to do that arguably expands bad faith liability in ways that may prove inefficient and unwise in situations where the claimant is not nearly so vulnerable as the average policyholder suffering a loss or facing a claim.

The failure of the traditional jurisprudence, in my view, is not its presumptive insistence on contract privity or its respect for the disclosed principal rule of agency. The historical approach has become problematic, not because of the contract underpinnings of the bad faith tort, but because too many courts and litigants have seen adjuster liability as an all-or-nothing proposition. Either the adjuster is liable in bad faith, or the adjuster is immune. There is an intermediate position. The adjuster should ordinarily be protected from imputed liability due to an insurer's misconduct, but the adjuster should be liable for negligence (or certainly for more egregious misconduct such as gross negligence or recklessness) based on basic tort principles and overarching agency axioms that overcome the protection provided by the disclosed principle rule.

As discussed below, one need not be in a contract relationship to owe tort duties to third parties and *Agency Restatement (Second)* §320 is really only a rule protecting agents for disclosed principals from being held to the contracts made by the principals through the agent.[30] It is not a general tort immunity statute for agents, and courts have erred to the extent they have expanded the Section to have this effect. Picking up on Ashley's critique, I agree that adjusters owe to policyholders the same duty of good faith owed by insurers as principals. Where insurance intermediaries have, in essence, 1) assumed the functions of the insurer (which seems to take place in many MGA and TPA operations, or where adjusters have

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[30] *See infra* notes 177-221 and accompanying text, proposing and defending tort liability for downstream intermediaries.

substantial discretion in evaluating claims), 2) are in a position of special relationship to a policyholder or other party, or 3) are in a "joint venture" with the insurer, intermediaries should be held to account as if they were the insurer, including facing bad faith exposure.

These downstream intermediaries may or may not owe good faith duties to claimants, depending on whether applicable state law permits claimants to make bad faith claims against a defendant's insurer. But these downstream intermediaries logically still owe at least tort duties to the claimant, even where the adjuster has more limited discretion. The nature of the intermediary-claimant relationship is one that should impose at least modest duties on the intermediary. Where the intermediary is negligent or reckless and causes injury, the claimant should not be barred from pursuing recompense through tort law.

Currently, because claimants initially and often have styled their claims against adjusters, TPAs, or MGAs as bad faith litigation, the field was shaped by cases like *Gruenberg* that found insufficient contractual connection to impose insurer-like obligations on the intermediaries. So bent, the branch of intermediary liability law grew from simply ruling that intermediaries were not liable to the extent of insurers, to assuming (and least in the seeming majority view) that intermediaries were not liable at all to third parties. But the latter legal rule does not follow even if one strongly accepts the former premise that bad faith liability for downstream intermediaries might be overkill.

In addition, the issue of adjuster or MGA liability has been unduly commingled with the question of whether a third party, such as an accident claimant, can sue an alleged tortfeaser/defendant/policyholder's insurer for bad faith in claims handling. The overwhelming majority of jurisdictions have refused to permit such claims, reasoning that they induce undue complications and conflicts into the liability claims adjustment process, which requires the liability insurer to defend the policyholder and thus focus its loyalty on protecting the policyholder/defendant rather than pleasing the third party who is suing the policyholder.[31]

For a ten-year period, California permitted such claims per the famous *Royal Globe*[32] case, but reversed field in its 1988 *Moradi-Shalal*[33]

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[31] *See* STEMPEL, *supra* note 27, § 10.05.

[32] *See* Royal Globe Ins. Co. v. Superior Court, 592 P.2d 329, 332 (Cal. 1979).

[33] *See* Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58, 60 (Cal. 1988).

decision. Although neither the California legislature nor the California Supreme Court shows any sign of returning to the *Royal Globe* regime, the intellectual argument on the issue continues. Like many observers, I continue to be relatively ambivalent about any perceived need to give tort plaintiffs and other claimants a direct bad faith right of action against liability insurers. Although scholars have made strong arguments in favor of this extension of the law and advocate *Royal Globe* as the preferred approach,[34] courts continue to adhere to the view that bad faith claims against the insurer belong to policyholders and not to tort claimants.[35]

Judicial opinions on the topic rely not only on maintaining some vestige of the historic citadel of privity but also upon the public policy view that providing third parties with an action for bad faith against insurers would introduce too much mischief into the claims settlement process, likely increasing the costs of the tort system and putting unwise additional demands on the legal system.[36] Although these arguments may well be overstated or even wrong,[37] they are not merely crabbed, formalistic

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[34] *See, e.g.*, Francis J. Mootz, III, The Sounds of Silence, supra note 29; Francis J. Mootz III, Holding Liability Insurers Accountable for Bad Faith Litigation Tactics With the Tort of Abuse of Process, 9 CONN. INS. L.J. 467, 507 (2002); Michael Cohen, Note, No Faith in Bad Faith, 41 HASTINGS L.J. 201, 225 (1989).

[35] *See generally* STEMPEL, *supra* note 27, Ch. 10.

[36] *See generally* Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58 (Cal. 1988).

[37] In California, for example, there was a nearly 10-year period in which *Royal Globe* was the law and third-party claimants could directly sue liability insurers for bad faith failure to settle claims against the insurer's policyholders. Needless to say, the world did not end during the ten years in which *Royal Globe* held sway. *But see* ANGELA HAWKEN ET AL., RAND INSTITUTE FOR CIVIL JUSTICE, THE EFFECTS OF THIRD-PARTY BAD FAITH DOCTRINE ON AUTOMOBILE INSURANCE COSTS AND COMPENSATION 52-53 (2001), *available at* www.rand.org/pubs/monograph_reports/2007/MR1199.pdf (concluding that the *Royal Globe* rule permitting third party claimants to sue defendants' insurers for bad faith resulted in auto insurance premium increases of more than 10 percent). What cannot be assessed from the Hawken study, however, is the degree to which any increase in premiums may have also purchased more responsible liability insurer/intermediary conduct that both better served claimants and policyholders and reduced costs imposed on the justice system and the taxpaying public.

West Virginia has for many years permitted modified *Royal Globe*-style actions. *See* Jenkins v. J.C. Penney Cas. Ins. Co., 280 S.E.2d 252, 254 (1981) (permitting a third-party claim against an insurer but requiring that underlying suit against policyholder be resolved first); *see also* Thomas C. Cady, et. al., *The Law of Insurance Company Claim Misconduct in West Virginia*, 101 W. VA. L. REV. 1, 70 (1988-1999). But this does not appear to be linked to any insurance or economic woes in that state. Further, some states, most prominently Wisconsin, have a direct action statute that permits claimants to sue for statutory rights similar to those available in a common law bad faith action. *See* Wis. Stat. § 632.24 (2007); *see also* Wis. Stat. § 632.34 (2007); *see also* Wis. Stat. § 803.04 (2007). Wisconsin's insurance situation does not appear to be any more problematic than that of California in the post-*Moradi-Shalal* era or that of other states barring claimant suits against insurers. *See also* La. Rev. Stat. Ann. § 22:655 (2008); *see also* La. Rev. Stat. Ann. § 22:983 (2008) (direct action statute); R.I. Gen. Laws § 27-7-1 (2008); *see also* R.I. Gen. Laws 27-7-2 (2008) (direct action statute). Jerry and Richmond observed:

> a few states and territories – Wisconsin, Louisiana, Rhode Island, Puerto Rico, and Guam – have "direct action statutes." The specific provisions of these statutes vary considerably, but their common characteristics are making the insurer directly liable to the injured party and permitting liability to be established in a single action against the insured and insurer jointly, or in an action against the insurer alone.

See Jerry & Richmond, supra note 15, at 628 (footnotes omitted). *See also* Viqar M. Shariff, Recent Developments, Grubbs v. Gulf International Marine Co.*: The Louisiana Supreme Court Declares the Direct Action Statute Applicable to Marine P & I Insurance*, 68 TUL. L. REV. 1653, 1653-54, 1662 (1994).

Other states, through judicial decision or statute, appear to permit claimant actions for bad faith even in the absence of a classic direct action statute such as Wisconsin's. *See, e.g.*, Macola v. Gov't Employees Ins. Co., 953 So. 2d 451, 452 (Fla. 2006) (claimant may bring action directly against defendant's insurer where there is verdict in excess of policy limits); *see also* Hovet v. Allstate Ins. Co., 89 P.3d 69, 71 (N.M. 2004) (recognizing *Royal Globe*-type action for auto liability only); State Farm Mut. Auto Ins. Co. v. Reeder, 763 S.W.2d 116, 117-18 (Ky. 1988) (interpreting Ky. Rev. Stat. Ann. § 446.070 to permit such actions); Mont. Code. Ann. § 33-18-242 (2005) (making *Royal Globe*-style action available to claimants for failure to attempt good faith settlement after liability has become reasonably clear). The availability in these states of this additional right accorded third-party plaintiffs appears not to have resulted in substantial economic or insurance mischief.

Under these circumstances, critics of the status quo such as Professor Mootz can legitimately argue that the existence of third-party standing to sue for bad faith assessments dependent upon only the privity of contract notion. It remains difficult (at least for me) to say with certainty whether the traditional view of generally limiting standing to sue for bad faith to insurance policyholders is clearly incorrect or misguided.

In addition, this seems to be an area where the legislative process has produced some positive reaction to a perceived insufficiency of common law judicial remedies for claimants aggrieved by insurer behavior. Nearly all states have some form of Unfair Claims Practices Act and nearly 20 permit third party claimants to sue insurers directly for violations of the relevant state Act.[38] In addition, a number of states permit third party claimants to sue insurers directly regarding policy coverage.[39]

Consequently, limiting common bad faith actions directly against insurers by third-party claimants due to absence of contract privity appears not to be a major defect of modern insurance jurisprudence (although neither does it seem essential to the effective operation of insurance). Some of the same arguments can of course be marshaled in favor of intermediary immunity. But properly assessed, the immunity of

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would encourage better behavior by insurers with relatively little negative external costs. But conversely, neither does it appear that the absence of these third-party rights has prevented policyholders and their proxies from enforcing good faith obligations upon insurers. Most commonly, where insurer bad faith occurs in significant degree, the policyholder assigns its potential rights of relief to the claimant and the action is pursued. Although insurers with less vigilant policyholders may "get away" with some bad faith conduct as a result of the status quo, this does not appear to be a gaping hole in the fabric of justice. More potentially troublesome is the U.S. Supreme Court's recent punitive damages jurisprudence, which as a matter of law has constitutionalized limits on punitive damages that may be imposed upon insurers even for intentional, serious, widespread, and long-standing bad faith conduct. *See* State Farm Mutual Auto. Ins. v. Campbell, 538 U.S. 408, 409 (2003); *see generally* JEFFREY W. STEMPEL, LITIGATION ROAD: THE STORY OF *CAMPBELL v. STATE FARM* Chs. 17, 22-23 (2008) (despite considerable evidence of record of insurer's recalcitrant insistence on treating liability policyholders in bad faith, presumptive maximum punitive damages limited to nine times amount of substantial compensatory awards).

[38] *See, e.g.*, State Farm Mut. Auto Ins. Co. v. Reeder, 763 S.W.2d 116, 118 (Ky. 1989) (interpreting KY. REV. STAT. ANN. § 446.070 to permit such actions); *see also* MONT. CODE. ANN. § 33-18-242 (2005); *supra* note 37.

[39] *See, e.g.*, *supra* note 37.

intermediaries is another matter, both in terms of public policy and law. Unfortunately, courts have tended to overly equate the concept of a direct tort victim action against the policyholder's insurer and a policyholder's action against the independent adjuster hired by its insurer.

For example, during the brief reign of *Royal Globe*, California courts appeared to accept the proposition that the state's Unfair Claims Practices Act applied to independent adjusters (and by inference other downstream intermediaries) because these adjusters were in the insurance business within the meaning and purpose of the statute.[40] However, since *Moradi-Shalal* deposed *Royal Globe*, several California courts have disapproved of these holdings, reasoning that if a third party cannot sue an insurer directly for bad faith, persons without a contract with an adjuster cannot sue the adjuster for bad faith.[41] The California Supreme Court has never resolved the issue and it remains a technically open one in the state, although most observers would probably conclude that the current California Supreme Court is unlikely to permit bad faith suits against

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[40] *See, e.g.*, Bodenhamer v. Superior Court, 223 Cal. Rptr. 486, 488-89 (Cal. Ct. App. 1986) (noting that it would "be odd to construe the [Unfair Claims Act] as prohibiting unfair settlement practices by employees of an insurance company but as not prohibiting identical acts when perpetrated by an independent adjuster working for an insurance company" and observing that licensing and regulation of adjusters fell under the auspices of the state insurance commissioner); *see also* Davis v. Cont'l Ins. Co., 224 Cal. Rptr. 66 (Cal. App. 1986); *see also* James I. Devitt & Robert C. Hastie, Note, *Independent Insurance Adjusters Liable for Bad Faith: Fair or Farce?*, 64 W. ST. U. L. REV. 229, 233, 235 (1986-1987) (approving *Bodenhamer* and *Davis* results).

[41] *See, e.g.*, Stone v. New Eng. Ins. Co., 39 Cal. Rptr. 2d 714. 730-31 n.26 (Cal. Ct. App. 1995) ("the *Davis* and *Bodenhamer* cases, which extended statutory bad faith liability to independent adjusters, were decided prior to the Supreme Court's decision in *Moradi-Shalal* and are now of doubtful validity") (citation omitted); *see also* Henry v. Assoc. Indem. Corp., 266 Cal. Rptr. 578, 585 (Cal. Ct. App. 1990). Even prior to *Moradi-Shalal*, some California decisions resisted holding independent adjusters accountable under the Unfair Claims Practices Act. *See, e.g.*, Santiago v. Employee Benefits Servs., 214 Cal. Rptr. 679, 684 (Cal. Ct. App. 1985); *see also* Richardson v. GAB Bus. Servs., Inc., 207 Cal. Rptr. 519 (Cal. Ct. App. 1984).

downstream intermediaries by parties not in privity of contract with the intermediary.[42]

Nothwithstanding the conventional wisdom, the assessment that adjuster statutory liability was erased by *Moradi-Shalal* is in my view incorrect, at least if the "third party" suing the adjuster is a policyholder of the insurer that retained the adjuster. Under these circumstances, it is quite clear to the adjuster that it is the representative of an insurer with fiduciary-like duties of good faith to the policyholder and that the policyholder is dependent upon the adjuster's actions just as it is dependent on the insurer's actions at a time of substantial vulnerability. A harder question is whether anyone other than the policyholder can lay claim to a statutory cause of action against the adjuster. But in between the extremes of no liability and bad faith exposure to a bevy of third parties, lies the reasonable common law compromise of permitting tort actions in negligence (or perhaps only for greater misconduct) against downstream intermediaries.

As a matter of legal realism, Ashley's lament that courts have focused too formalistically on privity of contract holds considerable force. Although MGAs and independent adjusters may not have formal contract relations with policyholders or others involved in the transaction, these intermediaries in essence assume the role of the insurer in addressing loss claims. Under these circumstances, courts have been too slow to realize that intermediaries playing this role have also in essence stepped into the shoes of the insurer for these claims and thus logically should be held to the same legal standards governing the insurer. In these cases, both policyholders and other reasonably foreseeable third party claimants should be able to bring claims if injured by the misconduct of the intermediary/insurer.

The problem is not that courts initially focused on the insurance contract and the covenant of good faith in articulating the existence of a bad faith cause of action against insurers. The problem is that courts have been too slow to realize an absence of contract rights hardly answers the question of whether one social actor owes duties to another. An obvious example is simply driving. We have no contract relations with other

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[42] For example, *Stone v. New England Insurance*, discussed in the previous footnote, was authored by Judge Walter Croskey, who is also co-author of the California Practice Guide on Insurance Litigation and an acknowledged authority on the topic. *See generally* 214 Cal. Rptr. 679; *see also* WALTER CROSKEY & REX HEESEMAN, CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION (2005).

motorists on the road, pedestrians, or bicyclists. But this is not any defense, much less an absolute defense, to our tort liability should we negligently injure any of these persons. The very nature of our activity in relation to these third parties creates duties of reasonable care.

The mistake of courts insisting on independent intermediary immunity is that they have wrongly assumed that the absence of a contract with policyholders not only fails to create contract rights but also erects a shield exempting the intermediary from the ordinary application of tort law. Under accepted tort law principles, claims intermediaries stand in a close relation to policyholders, are in a position to inflict considerable harm on vulnerable policyholders, and are well aware of their substantial power to inflict this harm. Injury to policyholders from wrongful behavior by adjusters is readily foreseeable. Courts have also been too reluctant to recognize that intermediaries assuming the functions of the insurer are a de facto part of that same contract and same covenant that protects policyholders by imposing legal duties on the insurer.

After decades of resisting recognition, courts like *Gruenberg* were finally recognizing what in retrospect seems obvious. A first-party insurance policy creates a special relationship between policyholder and insurer just as does a third-party insurance policy. Further, the first-party policyholder looking to an insurer to pay a property, life, health or disability claim is often just as vulnerable and dependent upon the insurer as is the third-party liability policyholder facing a lawsuit. But having just come to this realization, courts were understandably reluctant to immediately begin making this new action for first-party bad faith available against intermediaries as well as insurers.

Regardless of the issue of contract privity, there still remains the separate issue of whether the intermediary as a disclosed insurer's agent should be immune from tort-based claims for compensation by parties injured from the intermediary's activity. As discussed above, courts have traditionally taken this view but such cases are far less frequent than cases immunizing intermediaries on privity of contract grounds. Infrequent or not, however, this rationale remains one that must be addressed. Further, the agency rationale arguably has a sounder public policy grounding than the lack-of-privity defense to intermediary liability. One can argue with some force that intermediary liability is unnecessary so long as the insurer is itself held accountable for misconduct toward the policyholder. But ultimately the agency immunity rationale, like the lack-of-privity rationale, founders for the reasons set forth in the next section.

A. PROBLEMS OF THE NOW DATED TRADITIONAL APPROACH

Like the citadel of privity itself, the privity defense to agent immunity began to look shopworn over time and out of sync with modern commerce, as did the traditional rule of immunity for the agents of disclosed principals. The story of the fall of the citadel of privity in product liability tort law has been well chronicled in the near-century since the walls began to crumble.[43] Although retailers and manufacturers are not strictly in a principal-agent relationship, there are enough similarities to make this development of product liability law analogous to the eroding rationale for insurance intermediary immunity.

In the product liability context, society found retailers selling products that, if defective, could exact substantial injuries on consumers and the public generally. If Marley's products are adulterated and Dickens consumes them after purchase at Cratchett's corner store, an odd variant of the earlier hypothetical illustration occurred. Dickens was injured (physically as well as economically). If he had purchased knowing that Cratchett was but an agent for Marley, he would have a cause of action against the deeper-pocketed Marley. But because the Dickens contract is with Cratchett, traditional contract warranty law and tort law gave Dickens a legal claim only against the more modestly heeled Cratchett.

In a world prior to the widespread sale of commercial general liability insurance, this potentially left Dickens with little hope for significant compensation, unless he was willing to force a sale of Cratchett's assets and potentially remove a well-liked merchant and store from the neighborhood. The real culprit is Marley, purveyor of adulterated products, but under the traditional privity of contract rule, he lay beyond the reach of tort or contract law in any claim by Dickens.

The situation soon proved untenable from a public policy perspective. Once New York Court of Appeals Judge Benjamin Cardozo broke through the formalist barriers to a saner approach in *MacPherson v.*

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[43] *See* Dobbs, *supra* note 9, § 353; M. STUART MADDEN, PRODUCTS LIABILITY § 1.2 (2d ed. 1988); *see generally* William L. Prosser, *The Fall of the Citadel (Strict Liability to the Consumer),* 50 MINN. L. REV. 791 (1965-1966); William L. Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer),* 69 YALE L.J. 1099 (1959-1960).

Buick, the walls of the citadel of privity began to crumble rapidly.[44] By the middle of the 20th Century, courts were permitting the Dickens plaintiffs of the world to successfully sue the Marley defendants under a theory of consumer product warranty or tort law product liability or both. Manufacturers and wholesalers could no longer hide behind contractual privity. Not only injured customers but often other third parties whose injuries were foreseeable could vindicate their legal rights.[45]

Similarly, retailers like Cratchett were unable to hide behind agency immunity. In operating retail establishments and making sales of products, they were in direct contractual relationships with consumers. They may have been agents of sorts for manufacturers but they were not pure agents acting only as conduits for the principal. They were free-standing contracting parties in their own right. As a result, consumers and the public had available to them a relatively broad scope of potential legal relief against multiple culpable defendants in cases of product liability. Although some may argue that the rights of injured product users are too broad and impose too great a burden on commerce, this legal regime enjoys general acceptance.[46]

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[44] *See* MacPherson v. Buick Motor Co., 111 N.E. 1050 (1916); *see also* Prosser, *supra* note 9, § 96; Dobbs, *supra* note 9, § 353 (2000); *see generally* Prosser, *Fall of the Citadel*, *supra* note 43, at 793.

[45] *See* Prosser, *supra* note 9, § 100.

[46] *See* Prosser, *supra* note 9, § 100. Dobbs, like other modern product liability scholars, also notes the degree to which perceived problems with the breadth of the mid-20th Century product liability regime resulted in some revision and arguable contraction in the scope of strict liability. Dobbs observes that the RESTATEMENT (THIRD) OF TORTS § 402A (1998):

> [D]rops all references to strict products liability. Its view is that courts have mostly come to apply negligence standards in determining design and warning defects, even when they maintained the language of strict liability. The effect, although not the language of the Products Restatement is that strict liability is retained when it comes to product flaws, but negligence or something very much like it, is the test of liability when it comes to design and warning defects.

Dobbs, *supra* note 9, § 353 (footnotes omitted).

Although the Dobbs analysis is correct as to the substantive law of torts, the pro-defendant product liability trends of the past 20 years have not in any

But the arguable flip side of the fall of the citadel of privity has yet to take place regarding insurance intermediaries – at least not completely -- even though the insurance industry arguably has changed in ways paralleling product sales and distribution. Cases today are divided regarding the liability of downstream intermediaries, with the majority clinging to the general rules protecting these intermediaries: privity of contract and disclosed principal grounds.

Until the mid-20th Century, insurers tended to themselves administer the policies they sold. The policyholder was billed for premiums by an insurance company employee. Documentary records were maintained by an insurer employee. When there was a claim (either first-party or third-party), the claim was handled by an insurer employee. This began to change significantly after mid-century as insurers increasingly outsourced policy administration and claims adjustment functions to independent contractors. By the 1980s, even the underwriting and policy placement functions had been outsourced by some insurers. Instead of compartmentalized outsourcing of billing, record-keeping, or claims adjustment, insurers increasingly made use of MGAs, who not only combined these functions but also in essence did the underwriting traditionally performed by insurers.

Some of the wave of solvency problems affecting insurers during the 1980s and early 1990s were blamed on the lax underwriting standards of MGAs, who had an economic incentive to write lots of business (and earn higher fees) while having comparatively less motivation to make sure that the policies were issued to good risks. When the figurative chickens came home to their metaphorical roost, there were a number of prominent insurance insolvencies. Although the solvency problems facing Lloyds of London were primarily rooted in long-tail asbestos and environmental coverage obligations, some of these problems – which led to the form of Equitas in 1996[47] were also ascribed to overly aggressive underwriting by

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appreciable way restricted a potential plaintiff's array of potential target defendants. Manufacturers, wholesalers, distributors, retailers, and installers are all subject to suit by foreseeable product users while the "disclosed principal" and "lack of privity" defenses have generally not been available to defendants.

[47] *See* Lloyd's v. Jaffray, (1999) Q.B. (Colman, J) (describing background of Lloyd's crisis of early 1990s and formation of Equitas Re); *see generally* ELISABETH LEUSSENHOP & MARTIN MAYER, RISKY BUSINESS: AN INSIDER'S ACCOUNT OF THE DISASTER AT LLOYD'S OF LONDON (1995); *see also* Richard J.

MGAs for American insurers reinsured by Lloyd's or involved in risk placement for which Lloyds' syndicates provided excess or umbrella insurance.

My concern in this article is not whether independent contractors like MGAs and independent adjusters are better or worse at their jobs than insurer employees or their respective contribution to problematic insurance practices. My point and contention is much narrower and simpler. For better or worse, these intermediaries have assumed many of the traditional functions of an insurer to a sufficient degree that for most practical purposes, the actions of the intermediary are the actions of the insurer.

Under these circumstances, the traditional citadel of contract privity now seems as outmoded in this situation as it does in the context of product liability. In addition, these intermediaries have morphed from mere agents into the alter ego replacements of insurers, as least as respects their dealings with policyholders and the public. Consequently, a rule of law immunizing them from the consequences of their conduct toward these groups appears increasingly outdated, unfair, and insufficiently deterrent of negligent or wrongful behavior by these intermediaries.

Some of the problem may result from the relative youth of the bad faith cause of action, particularly in first-party cases. Liability insurers have been subject to bad faith faith claims for as long as 75 years in some jurisdictions. But many states did not solidify this potential exposure until the 1960s or later. First-party bad faith came later, essentially being birthed in the 1970s or later.[48] When confronted with these relatively new causes of action against insurers, courts were understandably reluctant to expand bad faith liability to entities other than the insurer. Until courts better understood the relatively new tort of insurance bad faith, they were inclined to apply traditional agency and privity of contract rules as a means of regulating the spread of bad faith claims.

Astor, *Lloyd's of London: The Curious Case of Equitas Re*, 23 AM. BANKR. INST. J. 32 (2004).

[48] *See* STEMPEL ON INSURANCE CONTRACTS, *supra* note 27, Ch. 10; *see also*, *supra* notes 24-29.

B. THE HALTING MODERN EMERGENCE OF INTERMEDIARY LIABILITY

As the use of intermediaries increased in the claims process, there was of course a corresponding increase in complaints about the manner in which they performed this function. When denied insurance coverage or victimized by claims handling misconduct, aggrieved policyholders and claimants brought suit against the intermediaries as well as the insurers involved. Although the intermediaries often avoided liability under the traditional immunizing doctrines of lack-of-privity and agent-for-a-disclosed-principal, an increasing number of courts recognized that the nature of the intermediaries' role made it inappropriate to apply the traditional rules.

The first prominent case to expressly impose duties to the policyholder upon an independent adjuster was *Continental Insurance v. Bayless and Roberts, Inc.*[49] In *Bayless*, the policyholder was sued due to explosion of a "paint pot" it owned that was used by the victim in painting aircraft. The insurer, using an independent adjuster, accused the policyholder of failure to cooperate and threatened to cease defense of the claim unless the policyholder agreed to a reservation of rights. The policyholder "refused to accept such a conditioned defense" and the insurer "withdrew from the case." Left in the lurch,

> B&R settled the tort action, agreed to entry of a consent judgment for $618,000, and then sued [insurer] Continental and its chief adjuster to recover the amount of the judgment as well as punitive damages. The case went to trial and resulted in an award of $622,000 in damages to B&R, based on the jury's finding that Continental and its adjuster, Arthur Stanford, had negligently conducted B&R's defense, and that the insurance company had breached its duty to defend its insured.[50]

On appeal, the Alaska Supreme Court agreed with the trial court that under these circumstances, the policyholder was entitled to make a bad

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[49] 608 P.2d 281, 288 (Alaska 1980).

[50] *See id.*, at 283-84.

faith claim against the adjuster, affirming the verdict as reasonable. The unfortunate adjuster found liable (Arthur Stanford) was branch manager of Underwriters Adjusting Company, an Anchorage-based "subsidiary of Continental Corporation" that functioned "as the claims department of Continental Insurance," which was also a subsidiary of Continental Corporation. Notwithstanding Stanford's perhaps incestuous relationship with the Continental family, it appears he qualified as an independent adjuster and was not sued in the capacity as an arguable individual employee of the insurer.

The policyholder had successfully accused Stanford of failing to adequately investigate the claim against it as well as failing to inform the policyholder regarding the case, all in breach of an asserted fiduciary duty that demonstrated "gross and wanton disregard" for the interests of the policyholder. Evidence presented at trial suggested that adjuster Stanford had failed to inform defense counsel of problematic facts and had failed to disclose to counsel that the insurer had authorized up to $10,000 to settle the case.

Relying on *Gruenberg*[51] and *Iversen*,[52] adjuster Stanford argued that he could not be sued because of his absence of a contractual relationship with the policyholder. Even though *Iverson* had, like *Gruenberg*, generally been viewed as a case tending to immunize intermediaries, the Alaska Court noted that even under *Iverson* a claim for relief could lie, describing *Iverson* as a case in which "[t]he court held that the agent's liability would depend upon the plaintiff's theory of recovery." If the plaintiff was asserting only contractual claims, California law per *Gruenberg* and *Iverson* barred the claims on lack-of-privity grounds and "Stanford could not be held liable for a breach of the fiduciary duty of good faith arising out of the insurance contract . . . ." However, intermediaries like Stanford "could be held liable for negligence arising out of a breach of the general tort duty of ordinary care."[53]

The *Bayless* Court's interpretation of California law is open to more than a little debate and appears to have been refuted by the latter state's continued practice of largely immunizing intermediaries during the

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[51] *See generally* Gruenberg v. Aetna Ins. Co., 510 P.2d 1032 (1973).

[52] Iversen v. Superior Court, 127 Cal. Rptr. 49, 50-51 (Cal. Ct. App. 1976).

[53] *See* 608 P.2d, at 287.

ensuing 17 years.[54] But regardless of whether *Bayless* correctly interpreted California law, it nonetheless provided a beachhead in opposition to the historical view that contract privity and disclosed agency protected TPAs and adjusters. The *Bayless* Court also saw its decision as a natural extension of Alaska law holding that an insurance agent could be liable for negligent failure to provide requested insurance even if the agent was working for an insurance company that was a disclosed principal.[55]

Bayless broke away from the traditional formal rule of adjuster immunity but hardly produced an avalanche of case law rejecting the rule. It would be six years before another state supreme court followed suit. In *Morvay v. Hanover Ins. Cos.*[56], New Hampshire took a similar approach. The home of the policyholders was destroyed by fire and they sought coverage from their property insurer, which retained an independent investigator to perform a cause-and-origin analysis of the fire.[57] The investigator subsequently assessed the fire as suspicious, leading to claim

[54] *See, e.g.*, Sanchez v. Lindsey Morden Claims Servs., Inc., 84 Cal. Rptr. 2d 799, 802-04 (Cal. Ct. App. 1999) (policyholder may not bring claim for injury based on independent adjuster's negligence).

[55] *See Cont'l Ins.*, 608 P.2d at 287-88 (citing Austin v. Fulton Ins. Co., 498 P.2d 702, 704 (Alaska 1972)). *Bayless & Roberts* remains good law in Alaska but there has not been any particular flood of litigation against adjusters, who appear to remain peripheral to much insurance coverage litigation. *See, e.g.*, Gibson v. GEICO Gen. Ins. Co., 153 P.3d 312, 316-17 (Alaska 2007) (affirming trial court decision to prohibit discovery directed at independent adjusters in policyholder's underinsured motorist claim made against her insurer). Oddly, the policyholder claimed only that she was owed additional UIM benefits from the insurer after having received $50,000 policy limits "plus $12,747.50 in add-ons" under the tortfeasor's coverage and did not allege bad faith against the insurer, which presumably would have opened the door to discovery from adjusters. *Id.* at 314. The policyholder prevailed at trial, but only to the tune of a few thousand dollars. *Id.* at 315-16. The opinion has an air of trying to put the case to bed and some annoyance with the policyholder (or counsel's) insistence on prosecuting a case of such limited magnitude.

[56] 506 A.2d 333 (N.H. 1986).

[57] *Id.* at 333.

denial by the insurer.[58] The policyholders sued the investigator as well as the insurer, alleging negligence in the conduct of the investigation.[59]

The trial court accepted the investigator's defense of lack-of-privity and dismissed the claim.[60] The Supreme Court reversed, finding that an investigative agent of an insurer conducting a claim investigation owed a duty of good faith to the policyholder "arising out of the [insurance] company's duty of good faith and fair dealing."[61] The Court bolstered its determination by noting that investigators were required to be licensed and were subject to a "general duty to use due care" in the performance of their work.[62]

In addition, the Court noted that existing precedent had held a bank responsible to a beneficiary with which it had no contract for failing to establish a survivorship account requested by the bank's customer.[63] A contractual tie was not necessary to create duties in that case because the bank was aware that the beneficiary would be harmed from negligent discharge of the bank's contractual duties.[64] Although the investigative agency and the individual investigator were not in privity with the plaintiffs,

> [T]hey were fully aware that the plaintiffs could be harmed financially if they performed their investigation in a negligent manner and rendered a report to [the insurer] that would cause the company to refuse payment to the plaintiffs. [They] were also aware that there was a mutual duty of fair dealing between [the insurer] and the plaintiffs.

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[58] *Id.* at 334.

[59] *Id.*

[60] *Id.*

[61] *Id.*

[62] *Morvay*, 506 A.2d at 334.

[63] *Id.* at 334-35.

[64] *Id.* (citing Robinson v. Colebrook Guar. Sav. Bank, 254 A.2d 837, 839 (N.H. 1969)).

> Under these circumstances, we hold that the plaintiffs have stated a cause of action in negligence [against the investigator and the employee.] . . . .
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> . . . Although . . . the investigators may give reports only to the insurer, the insured is a foreseeably affected third party. . . . Both the insured and the insurer have a stake in the outcome of the investigation. Thus, we hold that the investigators owe a duty to the insured as well as to the insurer to conduct a fair and reasonable investigation of an insurance claim and that the motion to dismiss should not have been granted.[65]

The *Morvay* Court also analogized the liability of the investigator to that of accountants, who "are liable in an action sounding in negligence to that group of persons who foreseeably may rely on the accountants' work."[66] Consequently, "accountants may be held liable to persons with whom they are not in privity if they perform their work negligently and the plaintiffs are within the class of persons who could have reasonably relied on the accountants' work product."[67] Without actually articulating the connection, the Court had implicitly put the relatively new wine of claims intermediary liability in the old skin of liability for misconduct that causes foreseeable injury to a known person or class of persons, something that had been part of the majority rule regarding public accountant liability for more than 50 years[68] and was also part of the accepted approach to the

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[65] *Id.* at 335 (citing Cont'l Ins. Co. v. Bayless & Roberts, Inc., 608 P.2d 281, 287-88 (Alaska 1980)).

[66] *Id.*

[67] *Id.* (citing Spherex, Inc. v. Alexander Grant & Co., 451 A.2d 1308, 1312 (N.H. 1982)).

[68] *See* RESTATEMENT (SECOND) TORTS § 552 (1977) (auditor liable to foreseeable users of audit for negligence). *See, e.g.*, Nevada Nat'l Bank v. Gold Star Meat Co., Inc., 514 P.2d 651, 654 (Nev. 1973); M. Miller Co. v. Central Contra Costa Sanitary Dist., 18 Cal. Rptr. 13, 15 (Cal. Ct. App. 1961). *But see*, Ultramares Corp. v. Touche, 174 N.E. 441, 444-45 (N.Y. 1931) (limiting auditor

liability of attorneys preparing instruments upon which non-clients would rely.[69]

Although the New Hampshire Supreme Court was potentially casting a very broad net of liability that included not only the entity involved in claims processing, but also individual employees working on a matter, it placed some practical theoretical limits on its expansion of intermediary liability.

> [T]he scope of the investigators' duty must be determined in the light of their contract with the insurer. The investigator who contracts to perform a $200 investigation is not obligated to expend the same effort that might be reasonable for a fee of $2,000, nor is an investigator obligated to continue an inquiry when the insurer instructs him to stop. The investigator's obligation is to exercise reasonable care in performing the work within the limits set by the insurer and to advise the insurer in the event that the investigator has reason to believe that the investigation is too limited to form the basis for a reliable conclusion.[70]

In essence, the *Morvay* Court was making the common sense conclusion that where a claims intermediary was acting as a surrogate or alter ego of the insurer, liability was likely to follow. But where the intermediary's role and authority were limited, the traditional defenses of lack of contractual privity and disclosed agency would likely continue to have force in apt cases.

After *Morvay*, it would be another five years before another state supreme court spoke in favor of the potentially emerging modern rule. Then, in *Bass v. California Life Insurance Co.*, Mississippi affirmed the general rule that the policyholder could not sue an independent adjuster for

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liability for negligence to situations where auditor is not in contractual privity to injured party).

[69] *See* RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 51 (2000); Greycas, Inc. v. Proud, 826 F.2d 1560, 1565 (7th Cir. 1987) (applying Illinois law).

[70] *Morvay*, 506 A.2d at 335.

simple negligence, but then broke ranks with the historical norm by also holding that a cause of action would lie if the independent adjuster had acted with gross negligence, malice, or reckless disregard for the rights of the policyholder.[71] However, the adjuster must have sufficient independent authority to make it more than simply an appendage of the insurer. If the adjuster lacks authority to rule on claims without insurer approval, the traditional rule of no intermediary liability still obtains.[72]

Additional support for the modern approach accelerated during the 1990s. Courts in New Jersey,[73] Georgia,[74] and Nevada[75] as well as some federal decisions[76] endorsed the view that intermediaries with substantial insurer-like duties and autonomy could be liable for bad faith or other misconduct toward the policyholder. In the 21st Century, Oklahoma

[71] 581 So.2d 1087, 1090 (Miss. 1991) (citations omitted).

[72] *See, e.g.,* Ironworks Unlimited v. Purvis, 798 F. Supp. 1261, 1265-66 (S.D. Miss. 1992) (acknowledging that *Bass* is controlling state law but distinguishing the instant case because the independent contractor adjuster lacked autonomy of adjuster in *Bass*). In a tangentially related development indicating relaxation of historical doctrine favorable to intermediaries, Pennsylvania held that brokers owe a duty of good faith and fair dealing rather than merely a duty of reasonable care. *See* Londo v. McLaughlin, 587 A.2d 744, 747 (Pa. Super. Ct. 1991).

[73] *See* Miglicio v. HCM Claim Mgmt. Corp., 672 A.2d 266, 273 (N.J. Super. Ct. Law Div. 1995). Regarding the rather complex web of bad faith and related liability in Pennsylvania, *see* Goren, *supra* note 26, at 276-81.

[74] *See* Gardner & White Consulting Servs., Inc. v. Ray, 474 S.E.2d 663, 665 (Ga. Ct. App. 1996).

[75] *See* Albert H. Wohlers & Co. v. Bartgis, 969 P.2d 949, 960 (Nev. 1998).

[76] *See, e.g.,* Wolf v. Prudential Ins. Co. of Am., 50 F.3d 793, 797-98 (10th Cir. 1995) (applying Oklahoma law) (finding a requisite special relationship existed between the medical plan beneficiary and the plan administrator where the administrator performed many of the tasks of insurer). *Wolf* not only correctly predicted the path of Oklahoma law but influenced it in that subsequent state decisions were persuaded by the reasoning of the *Wolf* court.

adopted this approach,[77] as did Colorado, specifically disapproving contrary precedent from the 1980s.[78] Favorable New Mexico precedent also emerged.[79] Most recently, a Rhode Island federal trial court predicted that the state would eventually permit bad claims against independent adjusters where the intermediary has sufficiently assumed the traditional administrative and adjusting functions of an insurer[80] and an Ohio appellate court has also written approvingly about this "management theory" of liability for parties linked to insurers when sued by persons not in direct contract privity with the defendant.[81]

The cases permitting actions against the adjuster tend to divide, a bit unevenly, as to both the type of action permitted and the factual

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[77] *See* Badillo v. Mid Century Ins. Co., 121 P.3d 1080, 1100-03 (Okla. 2005); Wathor v. Mut. Assurance Adm'rs, Inc., 87 P.3d 559, 562-63 (Okla. 2004); Brown v. State Farm Fire & Cas. Co., 58 P.3d 217, 223 (Okla. Civ. App. 2002).

[78] *See* Cary v. United of Omaha Life Ins. Co., 68 P.3d 462, 466 (Colo. 2003) (overruling prior contrary line of cases, including Gorab v. Equity Gen. Agents, Inc., 661 P.2d 1196, 1198-99 (Colo. Ct. App. 1983)).

[79] *See, e.g.*, Dellaira v. Farmers Ins. Exch., 102 P.3d 111, 115 (N.M. Ct. App. 2004) (largely following Colorado Supreme Court's analysis in *Cary v. United of Omaha*).

[80] *See* Robertson Stephens, Inc. v. Chubb Corp., 473 F. Supp. 2d 265, 274-275 (D.R.I. 2007).

[81] *See* Dombrowski v. Wellpoint, Inc., 879 N.E.2d 225 (Ohio Ct. App. Sept. 20, 2007). In *Dombrowski*, however, the issue for decision was slightly different in that it focused on whether a parent company of an insurer could be held responsible for insurer misconduct. *Id.* at 228-29. The federal court ruled that corporate separateness was not a bar to liability if the facts demonstrated sufficient parental company control over the insurer's coverage and claims decisions. *See id.* at 230. Although *Dombrowski* was in a narrow sense a "piercing the corporate veil" case, the court gave a rather ringing endorsement to what it termed the "management theory" of liability for parties not in contract privity with a plaintiff and cited approvingly Dellaira v. Farmers Ins. Exchange, 102 P.3d 111 (N.M. Ct. App. 2004), Delos v. Farmers Ins. Group, Inc., 155 Cal. Rptr. 843 (Cal. Ct. App. 1979) and other cases supporting liability for claims intermediaries that in effect take over the insurer's traditional claims handling and decision-making function. *Id.* at 235-39.

predicate required to impose liability on the claims intermediary. One group of cases is willing to permit bad faith or similar actions against the intermediary if it is in a collaborative "joint venture" arrangement with the insurer or otherwise has stepped into the shoes of the insurer for purposes of claims administration.[82] Another group permits claims against the adjuster based on a lower threshold of mere tort duties owed to the policyholder or other third party sufficient to permit a claim sounding in simple negligence.[83] Some jurisdictions appear to recognize both grounds for liability.[84] One court predicting state law was willing to allow a bad

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[82] *See, e.g.*, Albert H. Wohlers & Co. v. Bartgis, 969 P.2d 949, 959 (Nev. 1998) (bad faith claim against intermediary permitted if it is in a "joint venture" with insurer as evidenced by sharing of financial incentives); Farr v. Transamerica Occidental Life Ins. Co., 699 P.2d 376, 386 (Ariz. Ct. App. 1984) (same); Dellaira v. Farmers Ins. Exch., 102 P.3d 111, 115 (N.M. Ct. App. 2004). *See also id.* at 116 ("An insured's expectations of good faith handling and ultimate determination of his or her claim for benefits by the insurer extends no less to an entity that both handles and determines the claim than to the insurer issuing the policy. 'Absent the prospect of damages for bad faith breach, [the entity performing claims determination] has no incentive to pay in good faith[.]'") (quoting Cary v. United of Omaha Life Ins. Co., 68 P.3d 462, 468-69 (Colo. 2003)).

[83] *See, e.g.*, Bass v. Cal. Life Ins. Co., 581 So.2d 1087, 1090 (Miss. 1991) (intermediary can be liable for gross negligence, recklessness, or other misconduct exceeding mere negligence); Morvay v. Hanover Ins. Cos., 506 A.2d 333, 335 (N.H. 1986) (adjuster owes duty of reasonable care to policyholder and may be liable for negligence); Continental Ins. Co. v. Bayless & Roberts, Inc., 608 P.2d 281, 287-88 (Alaska 1980) (same). *See also* Shephard v. Allstate Ins. Co., 2006 U.S. Dist. LEXIS 562, at *18 (S.D. Ohio. June 6, 2006) (predicting that Ohio will eventually adopt this view).

[84] For example, a leading Colorado case, Cary v. United of Omaha Life Ins. Co., 68 P.3d 462, 468-69 (Colo. 2003), found defendant third-party administrator to have performed most of the functions normally done by insurer and to have a substantial financial interest in denying claims because of the administrator's reinsurance contract with policyholder municipality. Therefore, it was logical to hold the TPA to insurer standards of conduct and liability. *See also* Robertson Stephens, Inc. v. Chubb Corp., 473 F. Supp. 2d 265, 273-74 (D. R.I. 2007) (reading *Cary* as a case requiring substantial intertwinement of administrator and insurer similar to joint venture theory of *Wohlers* and *Farr* (*See supra* note 70) to impose bad faith liability on TPA. I read *Cary* more broadly as also permitting negligence and other tort actions against a TPA under apt circumstances even if the

TPA does not rise to the level of being a surrogate insurer subject to bad faith liability.

Oklahoma is clearly a jurisdiction that operates on a two-track system of liability for claims intermediaries. Two state supreme court cases have largely adopted the "joint venture" or "intertwinement of functions" theory of intermediary liability under which the claims intermediary may be sued for bad faith in the manner of an insurer if the facts demonstrate that the intermediary has largely assumed the functions of the insurer regarding policy administration, including wide discretion in claims decision-making, particularly if there are significant financial incentives for the intermediary to deny claims. *See* Badillo v. Mid Century Ins. Co., 121 P.3d 1080, 1101-03 (Okla. 2005) (refusing to dismiss bad faith claim against intermediary at pretrial stage); Wathor v. Mutual Assur. Adm'rs, Inc.., 87 P.3d 559 (Okla. 2004) (accepting joint venture theory of intermediary bad faith but dismissing instant claim as a factually insufficient as a matter of law). *But see* 87 P.3d at 564 (Opala, V.C.J. and Watt, C.J., dissenting on ground that preliminary facts entitled plaintiff to discovery on intertwinement issues and that general agency principles could support tort liability depending on facts adduced at trial).

In addition, Oklahoma has a strong precedent supporting the existence of a negligence cause of action against insurance intermediaries where the facts of the case establish sufficient connection to the plaintiff to create a duty of reasonable care. *See infra* text accompanying notes 151-52 (discussing the reasoning of Brown v. State Farm Fire & Cas. Co., 58 P.3d 217 (Okla. Civ. App. 2002) approvingly). The state Supreme Court has never cited *Brown*, a particularly odd omission in cases like *Badillo* and *Wathor*, which dealt with the issue of intermediary liability. My own theory is that the blinders counsel and courts occasionally put on themselves created a situation in which the Supreme Court was so focused on the bad faith claims as prosecuted by the plaintiffs in *Badillo* and *Wathor* that it did not think to address whether tort liability via negligence and the *Brown* precedent might be applicable.

In any event, although *Brown* has not had ringing endorsement from the state supreme court, it continues to be treated as authoritative Oklahoma law, both for its pronouncements on tortious interference with contract and its views on claims adjuster liability, the more germane part of the opinion for purposes of this article. *See, e.g.*, D & D Equip. & Supply Co. v. Certain Underwriters at Lloyd's London, 2007 U.S. Dist. LEXIS 74784, at *7-8 (W.D. Okla. Oct. 5, 2007); Ishamel v. Andrew, 137 P.3d 1271, 1274-75 (Okla. Civ. App. 2006). Brown also was favorably cited by a federal trial court applying Ohio law in an intermediary liability situation. *See* Shephard v. Allstate Ins. Co., *supra* note 76, at *17. At this juncture, it thus appears that persons aggrieved by claims intermediaries may pursue either a straight-forward negligence tort for recovery or seek to sue the intermediary for bad faith where the adjuster has sufficiently assumed core insurer operations.

faith claim against an administrator sufficiently intertwined with an insurer but refused to allow a simple negligence action against the administrator.[85] As discussed in more detail below, my proposed framework for intermediary liability would permit both types of actions against adjusters based on the facts of the particular case.[86]

Despite their differences at the margin, the common thread of these decisions is not so much a rejection of the general rule as a recognition that in many cases, insurance intermediaries act more like substitute insurers than mere agents. Almost all of the decisions sustaining liability claims insisted that the intermediary engage in more than merely ministerial and robotic claims handling commanded by the insurer as principal to the intermediary's limited agency.[87] Some of these decisions went further in

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[85] *See, e.g.*, *Robertson Stephens*, 473 F. Supp. 2d, at 273-78. The *Robertson Stephens* opinion is so thorough and scholarly that one flinches from disagreeing with it, even in part. However, the Court's refusal to permit a negligence action in a situation it found apt for a bad faith action seems irreconcilably inconsistent, even if it as a practical matter does not strip the plaintiff of any serious litigation prerogatives. (If the policyholder can sue for bad faith, suing for mere negligence is unlikely to lead to a greater recovery.) If the claims administrator is sufficiently linked to the insurer to be sued as an insurer and owe a fiduciary-like duty of good faith to the policyholder, this same administrator must also logically owe the policyholder at least a basic tort duty of reasonable care.

Robertson Stephens is a finely crafted opinion that seems to veer off track in this regard, although it was arguably forced to by controlling Rhode Island precedent, particularly the state's general hesitance to impose on commercial actors liability for negligence toward third parties. *See id.* at 276-81. The Court noted that it was "not entirely unsympathetic to Plaintiffs' call to augment in law the obligations of independent administrators . . . but Rhode Island precedents and the majority approach [of adjuster immunity absent a joint venture with the insurer] must stay the Court's hand. The Rhode Island Supreme Court is perfectly capable of pioneering new frontiers in the law of negligence on its own, and is in a better position to do so."). *See id.* at 280-81 (also noting that plaintiff chose federal forum and therefore cannot "grumble" about federal court reluctance to push boundaries of state law).

[86] *See infra* text accompanying notes 177-221.

[87] *Bayless & Roberts* and *Morvay* are arguably close to permitting liability even if the agency is limited. *See supra* notes accompanying text 49-63. For example, the *Robertson Stephens* court read them this way. *See Robertson Stevens*, 473 F Supp. 2d at 280. I disagree. In both *Bayless* and *Morvay*, the agents (an

requiring substantially autonomous claims administration so that the intermediary was in effect the decisionmaker regarding the claim and not merely a vessel of communication between insurer and policyholder.[88] Some also required a partnership or joint venture-like financial stake by the intermediary that gave it an incentive to dispute claims going beyond whatever natural tendency the adjuster might have to minimize payments in order to please the principle.[89]

As the Oklahoma Supreme Court observed:

> In a situation where a plan administrator performs many of the tasks of an insurance company, has a compensation package that is contingent on the approval or denial of claims, and bears some of the financial risk of loss for the claims, the administrator has a duty of good faith and fair dealing to the insured.[90]

If an intermediary "acted sufficiently like an insurer" to create a "special relationship" between policyholder and intermediary, the intermediary could be liable to the same extent as an insurer.[91]

Nevada took a similar view but couched it in perhaps problematic language requiring that the degree of the intermediaries assumption of insurer functions rise to the level of a "joint venture." The general rule of insurer immunity remained operative but where an intermediary was engaged in a "joint venture" with the insurer, the intermediary was subject

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investigator and an adjuster) had substantial autonomy in conducting their duties and substantial practical control over the outcome of the claims in question.

[88] Oklahoma's *Badillo* and *Wathor* cases fall into this category, as arguably does *Cary v. United of Omaha*. *See supra* notes accompanying text 78, 82-4.

[89] The joint venture cases, *Wohlers* and *Farr*, clearly are in this vein. Also, one might argue that *Badillo*, *Wathor*, and *Cary* also depended on some significant financial incentive impinging on the claims adjuster's ability to be fair.

[90] *See Wathor*, 87 P.3d at 563.

[91] *See id.* at 563. However, on the facts of that particular case, the Court found that the intermediary did not "act sufficiently like an insurer." *Id.* at 562.

to the duties of an insurer and faced potential liability similar to that of an insurer.[92] According to the Nevada Supreme Court, the instant case provided sufficient evidence of the requisite joint venture in that the intermediary

> [d]eveloped promotional material, issued policies, billed and collected premiums, adjudicated claims, and assisted [the insurer] in the development of [contract language]. Further, because [the intermediary] shared in [the insurer's] profits, it had a direct pecuniary interest in optimizing [the insurer's] financial condition by keeping claims costs down. [The intermediary's] administrative responsibilities and its special relationship with [the insurer are] indicative of the existence of a joint venture. . . .
>
> Due to the extent of [the intermediary's] administrative responsibilities, policy management duties, and special relationship . . . we conclude that [the intermediary and the insurer] were involved in a joint venture to an extent sufficient to expose [the intermediary] to liability on all contract-based and bad faith claims.[93]

Although the Nevada decision arguably would have been more doctrinally satisfying if it had simply said that MGAs or other intermediaries taking on insurer roles were subject to the law governing

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[92] In *Wohlers*, the court noted:

> In general, no one "is liable upon a contract except those who are parties to it." County of Clark v. Bonanza No. 1, 96 Nev. 643, 548-49, 615 P.2d 939, 943 (1980). However, according to a well-established exception to this general rule, where a claims administrator is engaged in a joint venture with an insurer, the administrator "may be held liable for its bad faith in handling the insured's claim, even though the organization is not technically a party to the insurance policy." William M. Shernoff et al., *Insurance Bad Faith Litigation* § 2.03[1], at 2-10 (1998).

Wohlers, 969 P.2d at 959 (citing *County of Clark* and William M. Shernoff).

[93] *See id.* at 959.

insurers (and dispensing with joint venture talk),[94] it was not only another state supreme court supportive of a departure from inflexible application of the historical rule but also provided a striking illustration of the degree to which MGAs in fact often take over insurer functions. The MGA found liable in Nevada's *Wohlers* decision was a world away from the traditional limited autonomy agents the law envisioned when it adopted the historical rule of intermediary immunity when the agent's principal was disclosed.[95]

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[94] The very terminology "joint venture," tends to conjure up images of major, formal business combinations and thus subconsciously suggests that much is required before MGA or claims intermediary can be held liable like an insurer. However, all that is really necessary is relatively standard administrator or adjuster behavior. When the joint venture language is peeled back, the Nevada Supreme Court appears to be saying that where an intermediary acting within its authority makes a key coverage decision in place of the insurer, the intermediary should be liable like an insurer, particularly if the intermediary has economic incentives adverse to coverage and is involved in significant administrative operations for the insurer.

In adopting the joint venture terminology and concept, the Nevada Supreme Court was obviously influenced by the treatise it cited authored by prominent California policyholders' attorney William Shernoff. Shernoff characterized pre-*Wohlers* case law as supporting MGA and adjuster liability if they were sufficiently intertwined with the insurer to constitute a joint venture. Although this is one valid interpretation, one could as easily looked at the case law assessed by Shernoff and concluded that the pre-*Wohlers* courts were looking not so much for a joint venture as for situations in which the intermediary was making decisions historically made by the insurer rather than one of its agents.

[95] Nevada is not alone in its attraction to the joint venture rationale as well as the realization that much of modern insurance is administered not by the insurer itself but by intermediaries. *Farr v. Transamerica Occidental Life Ins.* Co. of Cal. took a similar approach and found, much like *Wohlers*, that a health insurer's independent claims adjuster was sufficiently economically linked to the insurer to be liable to the policyholder on a joint venture theory. *Farr*, 699 P.2d at 386.

Farr's imposition of liability upon an intermediary creates some tension in Arizona law because another prominent Arizona case is frequently cited in support of modern adherence to the traditional rule of adjuster immunity. *See* Meineke v. GAB Business Services, Inc., 991 P.2d 267, 271 (Ariz. Ct. App. 1999) (basing independent adjuster immunity on grounds of lack of contract privity). *See also* Napier v. Bertram, 954 P.2d 1389, 1394-1395 (Ariz. 1998) (independent insurance agent had no duty to taxicab passenger to ensure that taxicab company has required uninsured motorist coverage; Court feared that imposition of liability would "impose on agents a duty to a vast number of non-clients—literally all who reside in or travel in this state").

In *Cary v. United of Omaha Life Insurance*,[96] Colorado set forth one of the most recent and forceful rejections of the traditional approach. The City of Arvada provided a self-funded insurance program to its employees, one managed by United of Omaha and Mutual of Omaha of Colorado (the Plan Administrators). Thomas Cary's 15-year-old daughter shot herself while attempting suicide, incurring substantial injuries that required extensive medical treatment, including multiple surgeries and hospitalization. The Plan Administrators denied Cary's claim for benefits based on an exclusion in the policy for self-inflicted injuries. He responded by suing for benefits and seeking damages for bad faith against the Plan Administrators.

The trial court agreed with claimant Cary that the self-inflicted injuries provision of the policy was ambiguous and ruled in favor of coverage but held that the Plan Administrators could not be sued for bad faith because "Cary was not in contractual privity with the Administrators." The Colorado Court of Appeals affirmed on similar grounds. The Colorado Supreme Court reversed, stating that it disagreed with the court of appeals' strict application of a privity of contract analysis to this case. Here, the insurance administrators had primary control over benefit determinations, assumed some of the insurance risk of loss, undertook many of the obligations and risks of an insurer, and had the power, motive, and opportunity to act unscrupulously in the investigation and servicing of the insurance claims. Under such circumstances, we hold that a special relationship existed between the Administrators and the insured sufficient to establish in the Administrators a duty to act in good faith.[97]

The cases are reconcilable in that *Meineke* based its holding on a view that in the instant case the "relationship between adjuster and insured is sufficiently attenuated by the insurer's control over the adjuster to be an important factor that militates against imposing a further duty on the adjuster to the insured." *Meineke*, 991 P.2d at 270. Neither *Meineke* nor *Napier* cited *Farr* but *Farr* remains good law in Arizona. Presumably, then, an Arizona court faced with adjuster-insurer intertwinement sufficient to make for a "joint venture" would, like the Nevada Supreme Court in *Wohlers*, refuse to immunize the intermediary.

[96] 68 P.3d 462 (Colo. 2003).

[97] *Id.* at 465. Under Colorado bad faith law, in order to prevail, Cary would be required to prove that the Plan Administrators had acted unreasonably and either "knew their conduct was unreasonable or acted in reckless disregard of whether their conduct was unreasonable." *Id.*

In addition to the these facts of Plan Administrator authority and conduct that supported permitting the claim, the Court also made a legal analysis differentiating cases of this type from those subject to the general rule of immunity from suit in the absence of privity. First, it noted that "insurance contracts are not ordinary commercial contracts" and that breach of the insurer's duty of good faith gives rise to a tort action.[98]

> In the typical insurance case, only the insurer owes the duty of good faith to its insured; agents of the insurance company – even agents involved in claims processing – do not owe a duty, since they do not have the requisite special relationship with the insured.
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> * * *
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> In the typical case, the insured is adequately protected by the non-delegable duty the law imposes on the insurer. However, the existence of this nondelegable duty does not mean that a third-party claims administrator never has an independent duty to investigate and process the insured's claim in good faith. When the actions of a defendant are similar enough to those typically performed by an insurance company in claim administration and disposition, we have found the existence of a special relationship sufficient for imposition of a duty of good faith and tort liability for its breach – even when there is no contractual privity between the defendant and the plaintiff.[99]

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[98] Colorado had not formally recognized first-party insurance bad faith actions until the mid-1980s. *See* Farmers Group, Inc., v. Trimble, 691 P.2d 1138, 1141 (Colo. 1984).

[99] *See Carey,* 68 P.3d at 466-67. As the Court noted, prior case law had already eroded the wall of immunity provided under the traditional rule. For example, in *Travelers Ins. Co. v. Savio,* the Court held that a workers compensation insurer owes a duty of good faith to the employees within the scope of the plan and not only to the employer who purchased the policy. 706 P.2d 1258, 1264-65 (Colo. 1985). In *Transamerica Premier Ins. Co. v. Brighton Sch. Dist.*, the Court ruled that sureties were subject to the bad faith regime that governed insurers. 27J, 940 P.2d 348, 352 (Colo. 1997). In addition, the Court had moved

Consequently, "[w]hen a third-party administrator performs many of the tasks of an insurance company and bears some of the financial risk of loss for the claim, the administrator has a duty of good faith and fair dealing to the insured in the investigation and servicing of the insurance claim."[100]

Two justices dissented, viewing the majority's expansion of potential liability to additional insurance activity participants as "unworkable" even it its social policy goal of protecting insureds "by providing a disincentive for wrongful behavior by agents of the insurer" as well as "an alternative source of recovery" was "laudable."[101] Invoking policy considerations of its own, the Dissent also argued that bad faith exposure for the Plan Administrator was inappropriate because it was obligated to serve the interests of the City of Arvada, which might often be in conflict with the interests of employees like Cary. Whatever empathy it felt for the family, the City might have preferred the claim be denied in order to have more coverage available for other matters or to keep payment for the program to a minimum.[102]

Even in California, often cited as the home of continuing adherence to the general rule that claims intermediaries as mere agents are not subject to suit, there is appellate court caselaw permitting such claims where the

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away from strict privity requirements in other contexts. *See, e.g.*, Cosmopolitan Homes v. Weller, 663 P.2d 1041, 1042-43 (Colo. 1983) (homebuilder owed duty of care to subsequent purchaser even if no contract privity between builder and purchaser).

[100] *See Carey,* 68 P.3d at 469.

[101] *Id.* at 469 (Coats, J., dissenting, joined by Kourlis, J.).

[102] In *Carey,* the court noted that:

> [T]he significance of [the Administrator's] involvement in processing claims for the City is not that it is acting *like* an insurer but rather that it is acting *for* an insurer. To the extent that it insured the City with a stop-loss or reinsurance policy, it has a "semi-fiduciary" relationship with the City, its insured, and owes the City a special duty that potentially conflicts with a similar duty to the City's insured.

Id. at 471 (emphasis in original).

intermediary has taken on the essential identity of an insurer or is intertwined economically with the insurer beyond a mere independent contracting relationship.[103] There is also some authority finding rights as intended third party beneficiaries for persons that are not part of the contract between policyholder and insurer,[104] although there is also much precedent taking a narrower view of entitlement to contract benefits.[105]

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[103] *See, e.g.*, Bus. to Bus. Mkts, Inc. v. Zurich Specialties London Ltd., 37 Cal. Rptr. 3d 295, 299, 300 (Cal. Ct. App. 2005) (surplus lines broker may owe duty to judgment creditor plaintiff for negligence in procuring insurance policy for judgment debtor policyholder that did not cover work done by policyholder in India); Tran v. Farmers Group, Inc., 128 Cal. Rptr. 2d 728, 740-41 (Ct. App. 2003); Delos v. Farmers Group, Inc.,155 Cal. Rptr. 843, 849 (Cal. Ct. App. 1979) ("for legitimate business considerations, the [administrative intermediary] was formed to render management services for the [insurer] for which it received a percentage of premiums paid by the [insurer's] policyholders"). *See also id.* at 653, 850 (administrative intermediary was "engaged in the business of insurance" and "may be held liable" under state unfair claims practices statute). *Id.*

The same is true for Arizona, which is generally considered a state favoring the traditional rule of claims adjuster immunity on the strength of Meineke v. GAB Business Services, Inc., 991 P.2d 267, 268 (Ariz. Ct. App. 1999), at least where the adjuster's agency authority is relatively circumscribed. But where the claim intermediary has substantial authority or more than a mere contract to perform ministerial services, Arizona courts have either permitted claims against the intermediary by policyholders or suggested that liability may be apt. *See, e.g.*, Gatecliff v. Great Republic Life Ins., 821 P.2d 725, 731 (Ariz. 1991) (recognizing management theory as basis for holding insurer responsible for TPA misconduct); Farr v. Transamerica Occidental Life Ins. Co. of Cal., 699 P.2d 376, 386 (Ariz. Ct. App. 1984) (TPA may be liable to policyholder when there is sufficient economic intertwinement with insurer to constitute joint venture-like linkage between them). *Accord*, Sparks v. Republic Nat'l Life Ins. Co., 647 P.2d 1127, 1137-38 (Ariz. 1982)(approving jury instruction on joint and several liability regarding claims intermediary handling investigation and payment of claims, determining joint venturers both owed common duty of good faith toward policyholders).

[104] *See, e.g.*, *Delos*, 155 Cal. Rptr. at 853. ("There are no public policy or doctrinal considerations that preclude Mr. Delos from having an independent cause of action against defendants. He was a party to the insurance contract and the effect upon him of the improper denial of his wife's claim was reasonably foreseeable").

[105] *See, e.g.*, Jones v. Aetna Cas. & Sur. Co., 33 Cal. Rptr. 2d 291, 294-95 (Cal. Ct. App. 1994) (tenant not intended third-party beneficiary to insurance

Although the state's Supreme Court has never endorsed any of these approaches, neither has it disapproved them in the context of claims intermediaries.

In addition, the "alter ego of the insurer" and "joint venture" theories are arguably perfectly consistent with famous California precedent rejecting claims against intermediaries (*Gruenberg*, *Egan*, *Iversen*)[106] in that in all of these cases, the Supreme Court considered the intermediaries to be engaged only in more limited, ministerial agency rather than a joint venture with the insurer or assumption of the insurer's role. Further, the immunity for insurance intermediaries, at least if they have substantial authority, would also appear to be inconsistent with state law permitting professionals such as an auditor or notary public to be held liable to persons that are not strictly part of the contract in question.[107]

Going into the 21st Century, one might have reasonably predicted increasing erosion of the traditional rule of claims intermediary immunity from suit by policyholders or other claimants allegedly injured by the intermediary's errors or misconduct. However, the formal doctrines shielding these intermediaries have proven surprisingly resilient.

C. THE PUZZLING PERSISTENCE OF THE TRADITIONAL RULE

Notwithstanding the emergence of a significant number of cases holding that intermediaries sufficiently assuming insurer functions could be liable to the same extent as insurers, many courts continue to apply the traditional doctrine and to accord broad immunity to MGAs and

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policy contract between lessor/policyholder and insurer). *See also id.* at 1724, 295 ("it is well settled that [California law] excludes enforcement of a contract by persons who are only incidentally or remotely benefited by it") (citing Cal. Civil Code § 1559 and Lucas v. Hamm, 364 P.2d 685 (Cal. 1961)).

[106] *See* Egan v. Mut. of Omaha Ins. Co., 620 P.2d 141, 154 (Cal. 1979); Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1038 (Cal. 1973); Iversen v. Superior Court, 57 Cal. App. 3d 168, 170 (Cal Ct. App. 1976).

[107] *See* Biakanja v. Irving, 320 P.2d 16, 17-19 (Cal. 1958) (notary public can be liable to persons reasonably expected to rely on notarization even if these persons were not in contractual privity with notary and person contracting to have signature notarized).

independent adjusters.[108] Courts continue to hold that a claimant does not have standing to bring a claim directly against an independent adjuster or administrator.[109]

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[108] *See, e.g.*, Wolverton v. Bullock, 35 F. Supp. 2d 1278, 1280-81 (D. Kan. 1998)(Kansas law does not permit policyholder to bring bad faith action against independent adjuster due to lack of contract privity); Natividad v. Alexsis, Inc., 875 S.W.2d 695, 698-9 (Tex. 1994)(policyholder may not sue independent adjuster for alleged bad faith in administering claim); Koch v. Bell, Lewis & Assoc., Inc., 627 S.E.2d 636, 638-39 (2006); Meineke v. GAB Bus. Servs., Inc., 991 P.2d 267, 270-71 (Ariz. Ct. App. 1999); King v. Nat'l Sec. Fire and Cas. Co., 656 So.2d 1338, 1339 (Fla. Dist. Ct. App. 1995); Larkin v. First of Georgia Underwriters, 466 So.2d 655, 657 (La. Ct. App. 1985) (insurance MGA not subject to bad faith claim by policyholder due to lack of contract privity); Egan v. Mut. of Omaha Ins. Co., 620 P.2d 141, 154 (Cal. 1979)(independent agents selling and servicing policies for disclosed insurer not subject to covenant of good faith and fair dealing with policyholder due to absence of contract privity); Troxel v. American States Ins. Co., 596 N.E.2d 921, 925 (Ind. Ct. App. 1992); Bentley v. N.C. Ins. Ass'n, 418 S.E.2d 705, 707 (N.C. Ct. App. 1992); Amica Mut. Ins. Co. v. Schettler, 768 P.2d 950 (Utah Ct. App. 1989). *Accord* Kim v. O'Sullivan, 137 P.3d 61, 62, 65 (Wash. Ct. App. 2006)(no policyholder cause of action against insurer-provided attorney for legal malpractice because of lack of express contract between attorney and policyholder); Scribner v. AIU Ins. Co., 647 A.2d 48, 51 (Conn. Super Ct. 1994)(no claim against attorney for insurer due to lack of contract privity). *See also* Badners v. Prudential Life Ins. Co. of America, 567 So. 2d 1242, 1244 (Ala. 1990)(no policyholder claim against bank that was supposed to debit monthly premium payments for life insurer due to lack of contract privity between bank and policyholder's ex-spouse, who suffered injury due to missed payments and lapsed policy prior to policyholder's death).

Kim v. O'Sullivan clearly seems wrongly decided. Although many states consider insurers to be "clients" of an attorney retained by the insurer to defend third party's lawsuit against a policyholder, all states consider the policyholder to be the lawyer's client by operation of law even in the absence of a written retainer agreement between counsel and the policyholder. Consequently, it simply cannot be correct that the policyholder has no claim for legal malpractice against a malfunctioning defense lawyer retained by its insurer. Some states even provide that only the policyholder is a client of the attorney and that insurers are but third party payers with contract rights vis-à-vis counsel.

[109] *See, e.g.*, Charleston Dry Cleaners & Laundry v. Zurich Am. Ins. Co., 586 S.E.2d 586, 588-89 (S.C. 2003); *Meineke*, 991 P.2d at 270; Sanchez v. Lindsey Morden Claims Servs., Inc., 72 Cal. Rptr. 2d 799, 802 (1999); King v. Nat'l Sec.

In some instances, legal arguments for removing intermediary immunity probably fall on deaf judicial ears because the facts of the case are not particularly compelling for the plaintiff. For example, in *Akpan v. Farmers Ins. Exchange, Inc.*,[110] the policyholders, owners of a convenience store, suffered three separate incidents of burglary and vandalism within a two-week period. Although this alone does not make the claim suspicious, the policyholders' post-loss behavior undoubtedly raised eyebrows as they backed out of submitting to an examination under oath on five separate occasions, ultimately refusing to answer questions about the losses. When they sued the insurer and independent adjuster, the court was not very sympathetic in view of the case's aroma of insurance fraud.[111]

Further, the policyholder claim against the intermediary was that it had been slow to deliver a copy of the policy to the claimants. Because the duty to cooperate and submit to examination if requested is so common in first-party property insurance, it is hard to take seriously the contention that without a copy of the policy, the insured was unsure of its basic obligations in this regard. Even if the delay in furnishing a copy of the policy was wrongful and unreasonable, *Apkan* hardly presented an attractive case for

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Fire and Cas. Co., 656 So.2d 1338 (Fla. Dist. Ct. App. 1995); Velastequi v. Exch. Ins. Co., 132 Misc.2d 896, 897 (N.Y. Civ. Ct. 1986).

As previously discussed, the judicial immunity for adjusters facing lawsuits from claimants is hardly surprising in light of the general rule that third party claimants may not sue insurers (other than their own) directly because of the law of privity. *See* notes 8-12, *supra*. If there has been bad faith by the insurer, the claim is often pursued by the claimant possessing an assignment of rights from the policyholder. In some states, bad faith claims are considered personal and non-assignable. In these states, a policyholder may agree to sue its insurer for bad faith and to award most of any proceeds from the suit to the third-party claimant as a means of settling the underlying tort litigation between the claimant and the policyholder.

110 Akpan v. Farmers Ins. Exch., Inc. 961 So.2d 865, 866 (Ala. Civ. App. 2007).

111 *Id.* at 867-71 (emphasizing importance of policyholder's compliance with policy provision requiring it to submit to examination under oath if requested by insurer).

departing from the traditional rule and permitting suit against the independent adjuster.[112]

Dear v. Scottsdale Insurance Co.[113] presented similar problems for the cause of law reform. Policyholder Dear was a private investigator with professional liability coverage. He was sued by a former client for alleged overcharging and "fraudulent and negligent" investigation. During mediation, the former client made a policy limits ($300,000) demand to resolved the case, one which the mediator had advised the insurer that it would be "well advised to accept [plaintiff's] policy limits demand" and that the mediator "believed that a jury might find against Dear" and award significant damages."[114] Not surprisingly, the insurer settled, as was its right under the terms of the liability policy. In a subsequent smaller case, Dear was sued by the former client's mother for an allegedly intrusive investigation in retaliation and then was sued by two other clients for "improprieties while investigating their daughter's disappearance."[115] The insurer settled both of these claims as well.

Demonstrating that good deeds rarely go unpunished, Dear sued the insurer, the adjuster, the insurance sales agent, and the law firm that defended the claims. His claim against the adjuster is that it changed its evaluation of the case in response to "pressure" from the defense attorney, conducted a poor investigation, settled a claim in spite of his objection, and tortiously interfered with his relationship with the insurer. Reading the case, one gets the impression that the policyholder was in essence suing the parties for saving him from himself. Clearly, he faced substantial claims

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[112] Nonetheless, the *Apkan* Court felt compelled to cite nearly all the modern cases on the subject, noted the majority approach, embraced the reasoning of majority rule cases, and rejected the analysis of cases like *Bayless and Roberts* and *Morvay*. *See Apkan*, 961 So. 2d at 873-74. *See infra* text accompanying notes 49-71 for criticism of the analyses of modern traditional rule cases such as Sanchez v. Lindsey Morden Claims Servs., Inc., 84 Cal. Rptr. 2d 799 (1999) and Meineke v. GAB Bus. Servs., 991 P.2d at 267, both of which have been influential in shoring up traditional intermediary immunity in the faces of cases like *Morvay* and *Bayless and Roberts*.

[113] Dear v. Scottsdale Ins. Co., 947 S.W.2d 908 (Tex. App. 1997).

[114] *Id.* at 911.

[115] *Id.* at 911-12.

that could have resulted in an excess verdict and his own personal exposure had settlement not been effected. The claim of settlement without confidentiality, however, is more compelling in view of the bad publicity that dissemination of the lawsuit information could produce for someone in Dear's line of work.

Nonetheless, the case as a whole is not one that would likely prompt a court to make new law to assist a sympathetic claimant. The *Dear* result – continued adherence to the rule of intermediary immunity, was also aided not only by a relatively recent state supreme court decision affirming adjuster immunity[116] but also by substantive Texas law which does not impose on insurers a specific common law duty of good faith in the investigation and defense of claims, although it requires insurers to accept reasonable settlement offers within available policy limits.[117]

But even where the policyholder's plight is sympathetic, a number of modern cases continue to cleave strongly to the traditional rule. In *Troxell v. American States Insurance Co.*, the policyholders suffered a home fire.[118] The insurer hired an independent investigator to perform a cause and origin analysis of the fire, which resulted in an adverse

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[116] *See id.* at 916 (citing Natividad v. Alexsis, Inc., 875 S.W.2d 695, 698 (Tex. 1994)).

[117] *See id.* at 914, (citing Maryland Ins. Co. v. Head Indus. Coatings & Servs., Inc., 938 S.W.2d 27, 27-29 (Tex. 1996)).

The duty to settle in Texas is routinely labeled the "*Stowers* duty" but Texas common law has otherwise been resistant to imposing other good faith obligations on insurers. However, Texas policyholders enjoy significant statutory rights and remedies. *See, e.g.,* TEX. INS. CODE ANN. § 541.151 (2005) (unfair and deceptive practices in the business of insurance); TEX. INS. CODE ANN. § 542.060 (unfair claims settlement practices); TEX. BUS. & COM. CODE ANN. § 17.41-17.826; Warren v. State Farm Mut. Auto Ins. Co., No. 3:08-CV-0768-D, 2008 U.S. Dist. LEXIS 68646 (N.D. Tex. Aug. 29, 2008) (insurer defendant seeking to remove policyholder statutory claim to federal court bears heavy burden to demonstrate lack of any reasonable basis for recovery under Texas unfair claims practices statutes); South Texas Med. Clinics, P.A. v. CNA Fin. Corp., No. H-06-4041, 2008 U.S. Dist. LEXIS 11460 (S.D. Tex. Feb. 15, 2008) (Chapter 542 claim requires that there be coverage under the policy at issue to permit unfair practices claim and Chapter 541 claim may be sustained on unfair claims practices independent of coverage determination).

[118] 596 N.E.2d 921 (Ind. Ct. App. 1992).

evaluation and the policyholder being "indicted on charges of arson" with the investigator serving as a prosecution witness at trial.[119] After the policyholder was acquitted, she sued the insurer and investigator.[120]

The suspicions of arson may have been reasonable (depending on the evidence), but if they were not the investigator's activity caused more than a little harm to the policyholder, harm that was readily foreseeable to an investigator that should at least constructively have been aware that in acting as an agent of an insurer it was required to proceed with good faith toward the policyholder.[121] But the court remained unmoved by Troxell's plight, at least as respects the immunity of intermediaries. The investigator "was the agent of [the insurer] and had no direct [contract] relationship" with the policyholder and hence was immune from suit.[122]

If nothing else, the sheer weight of history and precedent have made it difficult for reformist decisions such as *Bayless & Roberts*,[123] *Morvay*,[124] or *Cary*[125] to get traction in other jurisdictions. For example, the South Carolina Supreme Court, although aware of the split in authority on the topic, viewed immunity for intermediaries as continuing to be the solidly entrenched majority rule.[126] "We decline to recognized a general duty of due care from an independent insurance adjuster or insurance adjusting company to the insured, and thereby align South Carolina with the majority rule on this issue."[127]

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[119] *Id.* at 922.

[120] *Id.*

[121] *See id.* at 925.

[122] *Id.* at 925, n.1.

[123] 608 P.2d 281.

[124] 506 A.2d 333.

[125] 68 P.3d 462.

[126] *See* Charleston Dry Cleaners & Laundry, Inc. v. Zurich Am. Ins. Co., 586 S.E.2d 586, 588-89 (S.C. 2003).

[127] *Id.*

The Court based its continued preference for immunity on the state precedent holding that "foreseeability of injury is an insufficient basis for recognizing a duty" of good faith or reasonable care.[128] It also strongly suggested that intermediary liability was unnecessary because "a bad faith claim against the insurer remains available as a source of recovery for a [policyholder] plaintiff" [and that] "in a bad faith action against the insurer, the acts of the adjuster or adjusting company (agent) may be imputed to the insurer (principal)."[129]

Despite the strong support for intermediary liability (at least when the intermediary steps significantly into the shoes of the insurer) expressed by the New Hampshire Supreme Court in *Morvay*,[130] neighboring Vermont took quite a different view some 20 years later. In *Hamill v. Pawtucket Mutual Ins. Co.*[131] the Vermont Supreme Court specifically rejected *Morvay* and affirmed a trial court's summary judgment in favor of independent insurance adjusters, finding no legal duty owed by the adjusters to the policyholders – at least for solely economic damages claimed from alleged negligent investigation and evaluation, including substantial delay in processing the claim.

In *Hamill*, the homeowner policyholder was away on a business trip during which a power outage took place, resulting in loss of heat to the home, frozen pipes, and subsequent pipe bursting and flooding.[132] When the policyholder sought recovery under the policy, the insurer contracted with independent adjusters to handle the claim.[133] The policyholder provided estimates of the damage ranging from $150,000 to $200,000.[134]

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[128] *See id.* at 588 (citing South Carolina State Ports Auth. v. Booz-Allen & Hamilton, Inc., 346 S.E.2d 324, 325 (S.C. 1986) (foreseeability of injury alone does not create duty owed to foreseeably injured party)).

[129] *See id.* at 589.

[130] 506 A.2d 333.

[131] 892 A.2d at 228-29.

[132] *Id.* at 227.

[133] *Id.*

[134] *Id.*

In response, the adjuster "rejected the estimates, accused [policyholder] Hamill of insurance fraud, and offered to settle the matter then and there for $5,000."[135]

Even if these allegations were true, the Vermont Court was unmoved.[136] Like the South Carolina Court in *Dry Cleaners*,[137] *Hamill* found foreseeable injury alone an insufficient basis for created a duty to the policyholder.[138] Siding with and citing cases for the majority rule, the *Hamill* Court found the adjuster protected by both the absence of a contract directly with the policyholder and that imposing liability would be "contrary to the law of agency" since the adjuster worked for a disclosed principal.[139]

Further, the Court found public policy considerations to weigh against imposing liability upon claims intermediaries because "in most cases, imposing tort liability on independent adjusters would create a redundancy unjustified by the inevitable costs that eventually would be passed on to insureds."[140]

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[135] *See id.* at 227. Hamill also alleged that after he rejected the adjuster's settlement offer, [adjuster] Andrulat did not get back to him for weeks, even though Andrulat knew or should have known that the water-damaged premises needed to be repaired immediately to prevent the possibility of mold growth. According to the complaint, [Hamill also alleged that] as a result of Andrulat's failure to carefully investigate Hamill's claims, to consider his repair estimates, and to make an immediate and thorough inspection of the subject premises, mold spread through the house, making it uninhabitable. [Had the adjustment process been conducted properly]...the interior of Hamill's house would have been gutted and rebuilt before the mold had begun to grow. *Id.*

[136] *Hamill*, 892 A.2d 226.

[137] 586 S.E.2d 586.

[138] 892 A.2d at 227-28.

[139] *Id.*

[140] *See id.* at 230-31 (noting that policyholder Hamill had settled bad faith and breach of contract claims against his insurer and that he had not produced any evidence that he had not been sufficiently compensated by that settlement).

In addition, "the insurer contractually controls the responsibilities of its adjuster and retains the ultimate power to deny coverage or pay a claim."[141] Another consideration was that

> to some extent, insurers can define and limit their risks, and set their premiums commensurate with those risks through conditions, limits, and exclusions in their insurance policies. . . . In contrast, absent any contract with insured, adjusters cannot circumscribe their potential risks and thus could face potentially open-ended liability. This is particularly troublesome because of the unlikelihood that an action claiming negligent mishandling of a claim would be available against even the insurer.[142]

The *Hamill* Court also rejected the argument that Vermont's unfair claims practices act or other insurance regulator statutes applied to independent claims adjusters.[143]

III. THE BENEFITS OF ACCOUNTABILITY: ILLUSTRATIONS OF THE POTENTIAL MISCHIEF OF INTERMEDIARY IMMUNITY

In spite of its tenacious persistence and resistance to cases like *Bayless*[144] and *Morvay*,[145] the traditional approach of intermediary immunity has become inappropriate to the modern world of insurance. Although cases like *Hamill*[146] in Vermont and *Charleston Dry Cleaners*[147]

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[141] *See id.* at 231.

[142] *See id.* (citing Sanchez v. Lindsey Morden Claims Servs., Inc., 84 Cal. Rptr. 2d 799, 801-03 (Cal. Ct. App. 1999) *and* Meineke v. GAB Business Servs., Inc., 991 P.2d 267, 271 (Ariz. Ct. App. 1999)).

[143] *See* 892 A.2d at 231-32.

[144] 608 P.2d 281.

[145] 506 A.2d 333.

[146] 829 A.2d at 230.

[147] 586 S.E.2d 586.

in South Carolina make substantial public policy arguments in favor of intermediary immunity, they are ultimately no more persuasive than the dated formalism of the citadel of privity or rigid adherence to the disclosed principal rule of agency law. These modern cases, like their predecessors, rest on a weak foundation of questionable empiricism and argument.

Examining a leading case favoring intermediary immunity serves to illustrate the comparative weakness of arguments for intermediary immunity. *Sanchez v. Lindsey Morden Claims Services, Inc.*,[148] is a case frequently cited in support of continued adherence to the traditional rule of intermediary immunity and is unusual in that, like the Vermont Supreme Court's *Hamill*[149] opinion (which built on *Sanchez*), it defends the traditional rule upon functional public policy grounds rather than merely invoking the formalism of disclosed agency and lack of contract privity, although those were also applied by the *Sanchez* Court.

In contrast to *Sanchez*,[150] *Brown v. State Farm Fire & Casualty Co.*,[151] like the Colorado Supreme Court's *Cary* opinion discussed above, rejects the traditional rule of intermediary immunity on the basis of extensive functional analysis rather than any outright refusal to follow traditionally venerable privity and agency doctrine.[152] Upon closer examination, the *Sanchez*[153] public policy reasons for the traditional rule wilt while the analysis of *Brown*[154] and *Cary*[155] (like *Morvay* and *Bayless & Roberts*) is more persuasive. However, because *Sanchez* and its deceptive policy-based assessment has been influential in shoring up the traditional

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[148] 84 Cal. Rptr. 2d 799.

[149] 829 A.2d 226.

[150] 84 Cal. Rptr. 2d 799.

[151] 58 P.3d 217 (Okla. Civ. App. 2002).

[152] *See supra* text accompanying note 84 (discussing *Cary* opinion).

[153] 84 Cal. Rptr. 2d 799.

[154] 58 P.3d 217.

[155] 68 P.3d 462.

rule of immunity in the aftermath of its rejection in states some states, some extensive analysis of *Sanchez* is required.[156]

Sanchez was in the business transporting commercial machinery and had purchased cargo insurance from Lloyd's of London.[157] While moving a commercial dryer to a customer in Los Angeles, the dryer was damaged.[158] Sanchez made a claim under the policy for repair as soon as possible, with apparent agreement that the damage could be repaired in about a week for a cost of $12,000.[159] Like many policyholders, Sanchez wanted things taken care of as soon as possible but he had a good reason beyond ordinary impatience.[160] The customer that was slated to receive the dryer was losing business every day that delivery was delayed.[161] Sanchez informed Lloyd's through its independent adjuster of the need for speed in handling the claim in order to prevent huge losses from accumulating (thereby at least arguably making Lloyd's responsible for these additional

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[156] 84 Cal. Rptr. 2d 799.

[157] *See* 84 Cal. Rptr. 2d at 800. More precisely, Sanchez had purchased cargo insurance from an underwriting syndicate at Lloyd's. *Id.* Although perhaps the most famous insurer in the world, Lloyd's is not actually an insurance company but is an exchange of sorts at which a number of underwriters operate as agents for syndicates that provide the financial backing for the operation. Typically, a prospective policyholder retains a broker in the United States (or elsewhere), who in turn contacts a Lloyd's broker, who arranges coverage through a Lloyd's underwriter. A similar process is followed for obtaining insurance from London Market insurers that might be analogized to an "off-Broadway" counterpart to Lloyd's. Consequently, where a policyholder sues for coverage, they are technically suing "Certain Underwriters" at Lloyd's rather than Lloyd's as an entity.

[158] *Id.*

[159] *Id.*

[160] *Id.*

[161] *Id.*

damages and a *Hadley v. Baxendale*[162] defense unavailable, at least if the insurer was in breach of the policy).[163]

Apparently unmoved by Sanchez's plight, the claims adjuster took three months "before the claim was paid and the repairs completed. As a result, the dryer's purchaser sued and . . . obtained a judgment against Sanchez" for (I am not kidding) more than $1,3 million.[164] Sanchez then sued Lloyd's under the policy and sued the adjuster "on a negligence theory," with the adjuster claiming immunity under the traditional lack-of-privity and disclosed agency defenses[165] seemingly well enshrined in California law.[166]

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[162] (1854) 156 Eng. Rep. 145.

[163] Under the rule of *Hadley v. Baxendale*, (1854) 156 Eng. Rep. 145, a party breaching a contract is not liable for consequential damages unless they not only flow from the breach but are also within the contemplation of the parties at the time the contract is made. *See* DAVID EPSTEIN, BRUCE MARKELL & LAWRENCE PONOROFF, MAKING AND DOING DEALS: CONTRACTS IN CONTEXT 831-846 (2d ed. 2002); Farnsworth, *supra* note 10, § 12.14.

As a matter of contract law, Sanchez might have been out of luck because most courts hold that the consequential damages in question must have been reasonably foreseeable at the time of contracting rather than after the loss event. In addition, Lloyd's could probably argue successfully that Sanchez should have come up with his own $12,000 for dryer repair and mitigated the damages rather than waiting for three months while Lloyd's and its adjuster apparently diddled. But even if consequential damages for the breach are not available, one can make a strong argument that taking three months to process an emergency claim after being put on notice by the policyholder constitutes bad faith and entitles the policyholder to damages (e.g., an adverse judgment by the customer) proximately resulting from the bad faith, provided that Sanchez's failure to mitigate does not cut off the claim.

[164] 84 Cal. Rptr. 2d at 800.

[165] *See id.* By suing the adjuster on a negligence theory, which of course sounds in tort, Sanchez was probably trying to avoid the problems facing him in prosecuting the breach of contract claim against the insurer due to the *Hadley v. Baxendale* foreseeability problem and his failure to mitigate consequential damages. *Hadley v. Baxendale*, (1854) 156 Eng. Rep. 145.

[166] *See* Egan v. Mut. of Omaha Ins. Co., 24 Cal. 3d 809, 824, 620 P.2d 141, 169 Cal. Rptr. 691 (1979); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 576, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973), discussed at TAN 27-42, *supra*.

Sanchez begins as a noble effort of a busy state court to take an in-depth look at the problem. It even cites Cardozo's classic work of sociological jurisprudence *The Nature of the Judicial Process.*[167] But despite theses pretensions, *Sanchez* quickly dissolves into what I term "pseudo-policy lite." This is the type of "analysis" that occurs when a court trots out non-doctrinal, seemingly prudential reasons for a ruling that are based primarily on assertion, illogic, poor reasoning, failure to consider other factors, or a misunderstanding of the manner in which either its rule or the rejected rule would operate. "Pseudo-policy lite" analysis pretends to be applying a real world appreciation of the collateral consequences of its decision making when it in reality is merely invoking over-simplified or misleading arguments that do not in fact square with reality.

Rather than basing its decision in favor of adjuster immunity upon California Supreme Court decisions pretty squarely on point (and which presumably controlled disposition of the case no matter how much commentators might criticize them),[168] the *Sanchez* Court chose instead to look at a relatively recent state supreme court decision limiting the liability

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[167] *See* 84 Cal. Rptr. 2d at 800-801 ("While courts do not generally make broad policy in the manner of legislatures, they do make policy decisions in the "gaps," filling in the "open spaces" or "interstices" of the law." (*citing* CARDOZO, NATURE OF THE JUDICIAL PROCESS 113-14 (1921))). Courts deciding questions of duty are engaged in the limited "legislative" aspect of the judicial function. From this promising premise, the *Sanchez* Court immediately slides into analogy to other California cases rejecting liability and a prediction of adverse consequences from adjuster liability that betrays lack of understanding about the operation of insurance intermediaries in the field.

The *Sanchez* Court is right to note, as did the Cardozo Court, that courts must often make policy-based assessments in determining the reach of common law liability. But, for reasons that I hope are apparent in this section's discussion, it did a weak job of public policy analysis. One wonders why, in view of the existing California Supreme Court precedent in *Egan* and *Gruenberg*, the *Sanchez* Court did not just declare adjuster immunity as a matter of settled doctrine. If it had, it would have arguably better served the nation by not being a part of the counterattack against a possibly emerging rule of intermediary responsibility for misconduct.

[168] *See supra* text accompanying notes 25-29 (discussing Ashley's criticism of *Gruenberg* and similar analyses limiting intermediary liability on privity of contract grounds).

of auditors to third parties[169] and a 40-year old decision permitting a beneficiary's claim for lawyer malpractice regarding a will that resulted in financial loss to the beneficiary.[170] *Sanchez* analogized claims adjusters to auditors in making its adjuster immunity ruling and minimized the analogy of adjusters to attorneys in attempting to avoid a precedent imposing liability.[171]

Rather than relying on the settled state law of adjuster immunity, the *Sanchez* Court took it upon itself to apply a set of factors generally used to determine the existence of a tort duty. Although this may have made for a more Cardozo-like analysis for the Court, it was both unnecessary and misleading in that the liability of auditors, particularly if they preparing statements for the public or dispersal to third parties, is less problematic than suggested by the *Sanchez* Court. Indeed, in most states auditors are subject to liability under these circumstances.[172] Although auditor liability

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[169] *See* Bily v. Arthur Young & Co., 834 P.2d 745, 760 (Cal. 1992) (discussed at *Sanchez*, 84 Cal. Rptr. 2d 800-802 (holding an auditor is liable only to clients, and not to third parties for negligent preparation of financial statement)).

[170] *See* Biakanja v. Irving, 320 P.2d 16, 18 (Cal. 1958) (discussed in *Sanchez*, 84 Cal. Rptr. 2d at 800-801 (holding a lawyer who renders a will void by negligently failing to have it properly witnessed owes a duty of care to the intended sole beneficiary)).

[171] After citing the *Biakanj v. Irving* case and acknowledging that attorneys enjoy less protection from third party claims than do independent insurance adjusters, the *Sanchez* Court seemed unwilling to wrestle with those implications. *See generally* Sanchez v. Lindsey Modern Claims Services Inc., 84 Cal. Rptr. 2d 799 (Cal. Ct. App. 1999). As discussed below, the degree of existing attorney liability to third parties makes a case for at least as much insurance claims intermediary liability to third parties. Lawyers stand in a significantly different position than do claims adjusters in terms of their role and the social interests at stake if they are made to compromise their traditional role of zealous fiduciary loyalty to the client that hires them. This could tag attorneys for liability that might, in part, be characterized as merely an outgrowth of steadfast loyalty to a mistaken client. In spite of this, lawyers generally, and in the insurance context in particular, are subject to significantly more liability exposure than independent claims adjusters under the *Sanchez* ruling, a fact that seriously calls into question the wisdom of the holding. *See infra* text accompanying notes 198-205.

[172] *See* DOBBS, *supra* note 9, at § 480; RESTATEMENT (SECOND) TORTS § 552 (1977) (auditor liable to third parties if third party's reliance on auditor work was

may be established precedent in California, the minority status of this immunity is not a particularly strong public policy argument for a rule of auditor immunity.

If the rule of auditor immunity is correct, one's first reaction may be to apply it to adjusters as well. But first reactions can be deceiving. On one hand, Auditors are to some extent the "weights and measures" yardstick upon which much of the modern financial system depends.[173] The seeming failure of auditors in notorious business meltdowns of the early 21st Century brought on the Sarbanes-Oxley Act, which moved auditing more toward being a regulated industry than an independent, self-regulating profession.[174] Even widespread misfeasance by independent adjusters, TPAs and MGAs does not pose the same danger to the economy and is unlikely to produce the type of social upheaval or legislative response spurred by perceived auditor failure.[175]

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reasonably foreseeable). The contrary rule largely immunizing auditors from tort liability (but permitting recovery where the third party was an intended beneficiary of the contract between client and auditor) ironically stems from a famous Cardozo opinion. *See* Ultramares v. Touche, 174 N.E. 441 (N.Y. 1931). The opinion was subject to criticism almost immediately upon its issuance and over time most jurisdictions have found the *Ultramares* precedent to grant too much protection to accountants. It arguably is an opinion in which then-Judge Cardozo erred in filling in the uncertain interstices of the law. But, of course, to the extent that California follows the *Ultramares* rule, the *Sanchez* Court was bound to follow the *Ultramares* rule. However, this hardly gave the *Sanchez* Court license to engage in a wide-ranging attempt to analogize auditors to accountants when there already existed reasonably clear adjuster precedent in California.

[173] Ironically, the same Judge Cardozo, who was so resistant to auditor liability to non-contractual parties in *Ultramares*, had recognized years earlier that a scale operation serving the public was responsible for any injury caused by reasonable reliance upon the supposed accuracy of its measurements. *See* Glanzer v. Shepard, 135 N.E. 275, 275 (N.Y. 1922).

[174] *See* 15 U.S.C. §§ 7201-7266 (2006). *See generally* Jeffery D. Van Niel, Enron – The Primer, *in* ENRON: CORPORATE FIASCOES AND THEIR IMPLICATIONS 16-17 (Nancy B. Rapoport & Bala G. Dharan eds., 2004); MIMI SCHWARTZ WITH SHERRON WATKINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON 94-96 (2003).

[175] *See, e.g.*, BARBARA LEY TOFFLER WITH JENNIFER REINGOLD, FINAL ACCOUNTING: AMBITION, GREED, AND THE FALL OF ARTHUR ANDERSEN 219-20

But more important is the degree of attenuation presented by auditor liability and adjuster liability. An auditor may perform work for a client and then, without its knowledge or permission, have that work shown to unknown third parties who later assert claims against the auditor when something goes wrong. In such cases, the auditors are truly being sued by complete strangers. By contrast, a claimant or a policyholder is hardly a stranger to the adjuster or TPA, even if there is not a formal contract between the adjuster and the claimant or policyholder. Consequently, the relation of auditors to potential claimants is quite distinct from that of claims adjusters and potentially much broader. Consequently, it hardly follows that if auditors are immune, adjusters must also be immune.

Despite these fairly dramatic differences, the *Sanchez* Court pressed the auditor analogy hard in arguing that imposing liability on adjusters would be a major breach of the principles of duty and tort law. "Like the auditors, the insurer-retained adjuster is subject to the control of its clients, and must make discretionary judgment call. The insurer, not the adjuster, has the ultimate power to grant or deny coverage, and to pay the claim, delay paying it, or deny it."[176]

While this is technically true, the insurer's final say in calling the shots of claims resolution hardly make the adjuster a mere functionary. Independent adjusters have substantial impact on claims outcomes in that they provide the insurer with a factual investigation and analysis of the claim, usually making recommendations as to denial, valuation, and payment of a claim. This is a far cry from a hypothetical Cratchett of the 19th Century simply selling the wares of Marley to customer Dickens.

In addition, the relationship of insurer to policyholder also logically affects the relationship of the insurer's agent to a claimant or policyholder. Insurers stand in quite a different posture to both their policyholders and even to third party claimants, than do ordinary contracting parties. The obligations of good faith and fair dealing that are often given a short shrift in much of the contract world (e.g., mere absence of fraud qualifies as good faith no matter how much a breaching party deprives the other of the benefit of the bargain) have real teeth when

(2003) (describing the closure of a famous accounting firm in light of criminal litigation and bad press stemming from its role as primary outside auditor to Enron).

[176] *See Sanchez*, 84 Cal. Rptr. 2d at 801-02.

applied to insurance. In some cases, an insurer may be held accountable for bad faith because of misconduct toward the policyholder even when it was not required to provide coverage.

Although third parties have fewer rights vis-à-vis the insurer, it is generally acknowledged that insurance has a public interest component as part of a system of social policy that requires at least reasonable behavior toward third parties. Although the insurer's well-known "duty to settle" is designed primarily to prevent the policyholder from facing uninsured liability, it also has elements of encouraging rational and expeditious dispute resolution so as not to unduly burden the state and society through litigation or other means.

The net result of all this is well-established legal doctrine that requires that an insurer not favor its own interests above the policyholder's.[177] Logically, this also requires that an independent adjuster or MGA may not favor the insurer's interest at the expense of the policyholder, and that the adjuster fairly, accurately, and competently evaluate claims against a policyholder that have invoked the insurer's duty to defend and settle. Because the insurance intermediary is not an agent acting as a mere conduit or solicitor, the intermediary logically has duties of reasonable care and fair dealing approaching that of the insurer. Further, those duties logically are owed to the policyholder as well as to the insurer since the adjuster has stepped into the shoes of an insurer that must give equal consideration to the rights of the policyholder in resolving claims.

In arguing that the insurer's final decision making authority excuses any intermediary responsibility to others, *Sanchez* failed to consider the nature of the intermediaries tasks and the nature of the insurance arrangement. *Sanchez* then made the argument that:

> [w]hile the insurer's potential liability is circumscribed by the policy limits, and the other conditions, limits and exclusion of the policy, the adjuster has no contract with the insured and would face liability without the chance to limit its exposure by contract. Thus, the adjuster's role in the claims process is "secondary," yet imposing a duty of care could expose him to liability greater than faced by his principal the insurer.[178]

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177 *See* STEMPEL ON INSURANCE CONTRACTS, *supra* note 27, at § 10.03.

178 *See Sanchez*, 84 Cal. Rptr. 2d at 802.

This argument seems both odd and empirically incorrect in that it takes the absence of traditional contract privity and instead of using it as a doctrinal defense attempts to turn it into a policy argument in favor of intermediary immunity. Although it probably should get points for creativity, it is wrong about the law. Although it is true that insurer coverage liability is generally restricted to the policy limits of the insurance in question, it is not true that this provides an ironclad safe harbor against further insurer liability.

Insurers may often be required to pay counsel fees or interest upon losing a coverage determination. They of course may also be responsible for incidental and consequential damages for failure to properly process a covered claim. Although this extra-limits liability is rare where the insurer has acted reasonably, volitional, unreasonable insurer conduct amounts to bad faith under the law of most states and makes these damages available to the policyholder (and often its assignees). For example, where a liability insurer (in California and most states) unreasonably fails to accept a settlement offer, the insurer is responsible not only for paying the policy limits, but also any judgment amount against the policyholder in excess of policy limits. Where the insurer's bad faith or other misconduct was the product of willful indifference to the rights of the policyholder, the insurer may be held liable for punitive damages.

In short, it simply is not true that insurers enjoy significantly more ability to limit their liability than do claims intermediaries. Under these circumstances, it is just plain strange that a court would feel itself compelled to declare immunity for these intermediaries on the ground that the absence of formal contracting somehow makes the adjuster's lot worse than that of the insurer.

The *Sanchez* Court also argues that since "[a]n adjuster owes a duty to the insurer who engaged him," a "new duty to the insured would conflict with that duty, and interfere with its faithful performance. This is poor policy."[179] Actually, it is poor analysis by the court. The claims

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[179] *Id.* (citing Gay v. Broder, 167 Cal Rptr. 123, 127 (Cal. Ct. App. 1980) (holding a home appraiser owes no duty of care to a home loan borrower because this would subject the appraiser to a conflict with the duty owed to the lender retained by the appraiser); Felton v. Schaeffer, 279 Cal. Rptr. 713, 716 (Cal. Ct. App. 1991) (holding a doctor hired by an employer to conduct a pre-employment physical owes no duty to the applicant); Keene v. Wiggins, 138 Cal. Rptr. 3, 7 (Cal. Ct. App. 1977) (holding a doctor used by a workers' compensation insurer to assess the alleged disability of an employee did not owe the doctor-patient duty of an accurate diagnosis to the employee)).

adjuster represents the insurer. By law, the insurer cannot give regard only to its own interests; it must not only consider the interests of the policyholder but give them at least "equal" consideration, a legal rule internalized in the custom and practice of insurance (where adjusters frequently describe their role as being required to "look for coverage" rather than "look for reasons to deny coverage"). The adjuster, like the insurer, therefore already has obligations to the policyholder. By immunizing the adjuster from a damages action, the *Sanchez* Court merely deprived the policyholder of a legal right that it already possessed, *i.e.*, a right to have the adjuster act in the same manner as the insurer is required to act.

More practically, the experience of decades of insurance claims adjustment in the field has already demonstrated that, despite the occasional glitches that produce coverage and bad faith litigation, insurers (and their intermediaries) generally do a reasonably good job of balancing the interests of policyholders against their own economic interests. Attorneys retained by insurers are often particularly exemplary in this

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For what I hope are reasons obvious to the reader, if not the *Sanchez* Court, these cases are inapposite to the issue of insurance claims intermediary liability. Recall that the adjuster stands in for the insurer, which is obligated to give equal consideration or even priority to the interests of the policyholder. By contrast, the home appraiser has only one interest: making sure that the home is not overvalued so that the bank does not loan more money for purchasing the house than is justified by the fair market value of the home.

Regarding doctors, the *Felton* and *Keene* cases, cited above, correctly state the historical rule but like the tradition of adjuster immunity, the tradition of doctor immunity is under attack and will, with luck, eventually fall. Physicians are publicly licensed professionals accorded substantial privileges that historically have also demanded at least some commitment to the public interest. They also swear a Hippocratic Oath in favor of assisting life and health when they can reasonably do so. It is borderline obscene to suggest that a doctor examining a job applicant or a workers compensation claimant has absolutely no obligation to notice obvious health problems and report them to the person under examination so that the person may obtain appropriate follow-up care – even if the person examined is technically not the doctor's "patient." The medical analogy to insurance intermediary liability is explored at *infra* text accompanying notes 201-202. *See also* Spaulding v. Zimmerman, 116 N.W.2d 704, 709-10 (Minn. 1962) (vacating a settlement in a case where defense lawyer learned of plaintiff's life-threatening medical condition through Civil Rule 35 independent medical examination and failed to make disclosure).

regard, arguing for the best interests of the policyholder even though it is the insurer that is paying the bills and the insurer that the attorney hopes will send additional business in the future.[180]

The strongest policy argument invoked by the *Sanchez* Court was the contention that "[t]he deterrent effect of imposing a duty on adjusters is questionable" because "[a]djusters are already deterred from neglect by exposure to liability to the insurer who engaged them, for breach of contract or indemnity." According to the Court, "[o]nly some modest additional deterrence, at most could be expected from imposing a new duty owed directly to insureds."[181] Although *Sanchez* acknowledged that "[i]mposing a duty also might benefit insureds by providing another source of recovery for injuries caused by negligent claims handling or investigation" the Court viewed this as "redundant" (in "most cases") because the insurer would also be liable for the adjuster's mistakes and "[th]hus making the adjuster directly liable to the insured would, again, confer only a modest additional benefit."[182]

Critical as I am of *Sanchez* and similar cases, I concede that this argument had some force even if the court's exposition of its rationale is a little melodramatic. For example, the court went on to note:

> Insurance is a highly uncertain and risky endeavor, because it requires accurate predictions about the occurrence and cost of future events. Insurers are able to define and limit the risks, and to set premium levels commensurate with the risks, using complex and nuanced contracts (policies). By contrast, adjusters hired by insurers have no contract with insureds, and thus no ability to define or circumscribe their potential risks or liabilities to insureds. If adjusters faced negligence liability to insureds, market forces would tend to drive adjusting activities in-house, where they could be shielded with contractual exclusions, disclaimers, and limitations. Thus,

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[180] *See infra* text accompanying notes 198-204 (comparing the role and liability of attorney intermediaries to that of claims adjusters).

[181] *See Sanchez*, 84 Cal. Rptr. 2d at 802.

[182] *See id.*

> imposing a duty would reduce, perhaps severely, the offering of independent adjuster services. Yet widespread market acceptance has shown these services to be useful and desirable.
>
> Those adjusters continuing to operate independently despite imposition of a new duty of care would attempt to buy insurance against this liability, or create their own cash reserves, adding these costs to their charges, and passing them on to the insurers who used the adjusters' services. These insurers, in turn, would add the cost to the premium charged to insureds. The insured thus would end up paying more for insurance without obtaining more value because, as noted above, adjuster liability would provide only a redundant source of recovery usually available from the insurer.[183]

Stripped of the excessive gloom-and-doom or parade-of-horribles rhetoric, the *Sanchez* Court is merely asking the rhetorical question: if the insurer ultimately is liable to the wronged policyholder, why does the policyholder also need a cause of action against the adjuster? It's a good rhetorical question, but not good enough to support continued adherence to a broad and inflexible norm of claims intermediary immunity.

It is also important to remember that (Cardozo, sociological jurisprudence, and legal realism notwithstanding) courts are primarily supposed to be deciding cases with reference to existing doctrine and case-by-case required modifications of doctrine rather than sweeping quasi-legislative public policy pronouncements and predictions such as those quoted in the passages quoted above. This portion of *Sanchez* reads like a legislative committee report more than a judicial opinion. But legislative committee reports are generally based on at least some fact finding through receipt of hearing testimony, staff research, and review of public comment submissions (although partisanship and interest group influence of course play a role). This portion of *Sanchez* reads as though it was taken verbatim from the musings of the adjuster's brief. It was rendered without supporting citation and is in part self-refuting, for the reasons discussed below.

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[183] *See id.*

To the extent that courts inevitably make some decisions on the basis of public policy rather than application of existing doctrine or the doctrinal refinements that result from treating like cases alike, *Sanchez* is still unsatisfying because it embraces (without benefit of electoral mandate) a view of public policy that is unduly protective of intermediaries for reasons that appear empirically incorrect. The object of law is not simply to provide some avenue for recompense when wronged (a view that might support *Sanchez*'s contention that one responsible potential defendant is enough). Rather, a rational legal regime should provide not just some incentives for good behavior but optimal incentives that accurately reflect the commercial and behavioral reality of the activity under scrutiny well as taking account economic reality.

On the economic reality score, the "no need for additional deterrence or compensation sources" rationale is not nearly as strong as suggested by the *Sanchez* Court. Although insurers do not fail with the seeming regularity of subprime mortgage lenders, dot.com start-ups, or restaurants, insurer insolvency is a real danger. If it occurs, the policyholder (or its proxy) may very well not be able to obtain recompense. Imposing liability in apt cases upon claims intermediaries does not unfairly create a deeper pocket for compensation but instead provides an alternative pocket that provides additional protection if the insurer is unable to pay the claim.

There may even be cases in which a reasonable adjudicator could find the claims intermediary to have liability even though the insurer does not. Had it been permitted to be litigated in full, *Sanchez* itself might have been such a case. Recall that the policyholder faced some significant coverage issues and arguably had failed to mitigate his contract damages. However, under the (admittedly rare) right set of circumstances, the adjuster might logically be held liable for tortuous conduct outside of the terms of the insurance policy, just as many jurisdictions permit recovery for bad faith treatment even when coverage did not exist or was doubtful.

But the risk that insurers will escape liability through insolvency is not the primary problem with the *Sanchez* view that adjuster liability is not necessary for reasonable deterrence. More problematic is that adjuster and insurer incentives are often misaligned in a manner that does not by any means ensure that in the event of policyholder mistreatment by the adjuster, the insurer tagged with responsibility will pursue the adjuster, thus creating sufficient consequences to in turn provide an adequate incentive for the adjuster to treat policyholders fairly.

In real life, the insurer, even though perhaps facing liability for adjuster wrongdoing, may be perfectly happy to have the adjuster taking sharp, unreasonable positions with the policyholder. If the insurer itself behaved directly in this fashion toward the policyholder, it would be at substantial risk of a bad faith judgment. Although the insurer remains responsible for most agent activity within the scope of the agency, juries might well tend to be more forgiving of the insurer in cases where the most egregious misconduct is committed by the independent contractor agent rather than the insurer itself.

Intermediary immunity allows insurers and their claims agents to engage in at least occasional episodes of "good cop/bad cop" in which the insurer portrays itself as very concerned for the policyholder, but unaware of adjuster misconduct or unable to control it because of the adjuster's independence and distant operations. Even if a reviewing jury finds severe misconduct by the adjuster, it may be reluctant to find bad faith by the insurer and award substantial damages to the insurer, when the insurer has not been actively engaged in wrongdoing. The adjuster agent dilutes any negative picture a jury might have of the insurer, but the adjuster itself cannot be held responsible for its active misconduct, even though jurors might well be diverted from focus on the insurer (either as principal or passive wrongdoer) because of the adjuster's active misconduct.

If nothing else, the buffering effect of the immune adjuster agent logically makes it far less likely that a jury will impose punitive damages on the insurer. Although the court can painstakingly instruct the jury that the insurer is responsible for the bad acts of the adjuster, but this hardly has the same force as seeing the insurer itself act with willful indifference to policyholder rights.

When *Sanchez* asserts that the "widespread market acceptance" of outsourcing the claims function demonstrates the utility and desirability of this delegation of insurer function, the court wrongfully forgets to ask whether this is good or bad for the policyholder. Insurers might indeed prefer to outsource the claims function – but this can be for reasons that are either good (cost-savings, expertise, flexibility) or bad (cheaper because shoddier, insulation of the insurer, a reflection of reduced concern for fair claims treatment). Insurers may find independent contractor adjusters "useful and desirable" but this hardly means they are good for policyholders. Further, regardless of whether outsourcing the claims function is good or bad on the whole, each individual policyholder is entitled to be treated fairly by whoever adjusts the claim.

The *Sanchez* Court is probably wrong in predicting that removing absolute immunity for independent intermediaries would drive the adjustment function significant more in-house for insurers. If independent adjusters are a money-saver for insurers, they will be inclined to continue following this business model, even if some of the savings are lost because of imposition of adjuster liability that will be spread and potentially passed on to policyholders.

But even if this *Sanchez* argument is correct, it hardly follows that a return to in-house claims adjusting is a bad thing. Returning more of the claims function to the insurer might well improve claims practices by creating a culture of improved incentives and concern for policyholders. It is a least plausible that outsourced adjusting (particularly when coupled with immunity) leads to lowered standards and a more short-sighted attitude toward the treatment of policyholders and others.

The independent adjuster arguably has a considerably more short term perspective on the process than the insurer that both must live with the results and wants to enjoy good public relations for customer retention, future marketing, and the insurer's anticipated receipt of premium payments from a satisfied customer who stayed with the company, because the insurer treated the policyholder fairly during the claims process. The very leanness and meanness of some independent adjusters that produces cost savings can contribute to shortcuts and slipshod claims processing. Adjustment by the insurer itself may cost more in initial operation but bring better results, both in terms of legal fairness and long-term cost savings stemming from reduction in disputes.

In addition, this portion of the *Sanchez* public policy analysis posits that removing immunity for disclosed agent adjusters would impose substantial additional costs on the claims resolution process. The *Sanchez* Court reasons as follows: liability for the intermediary will raise disputing and liability costs; this in turn will raise adjuster fees and insurance premiums; and therefore intermediary liability is bad. But this syllogism is far from self-evidently correct.

In a competitive market, particularly a "soft" insurance market, there may be enough adjusters competing for business that they will absorb the relatively modest cost of liability insurance spread through the overall pricing of their book of business. Alternatively, independent adjusters may be able to increase their fees, but insurers may not be able to pass these along (at least not completely or perhaps not substantially) as this risks losing market share to competitors.

More importantly: an increase in adjuster fees and insurer premiums is not necessarily bad if it results in better adjusting of claims and greater insurer supervision of adjusters and more reasonable adjuster and insurer behavior toward policyholders and claimants. Although no one wants unaffordable or unavailable insurance, low premium insurance is of little or no real value if the insurer and its claims intermediaries fail to accord apt treatment to policyholders and claimants. In addition, there is considerable social cost if insurance error leads to economic waste, dislocation, or intervention (*e.g.*, public assistance for the unfortunate policyholder who should have been protected by insurance that it had purchased).

There is considerable wisdom in the adage that "you get what you pay for." The *Sanchez* Court wrongly assumes that lower costs for vendors is always good (irrespective of their performance and incentives) and that expansion of liability is always bad. The tradition of disclosed agent immunity stems from the Dickensian time of Marley, but in its modern form bears more resemblance to Scrooge. Essentially, the *Sanchez* Court is implicitly arguing that the simple fairness of holding adjusters accountable for the damage they inflict on policyholders or claimants is a burden victims should simply bear for the supposed greater overall good of hypothesized lower adjuster fees and insurance premiums.

More important, *Sanchez* overlooks that the insurer's chief duty is not to make insurance premiums as low as possible. Rather, the main obligation of an insurer is to the policyholder suffering a potentially covered loss. The insurer is required to act reasonably and give equal consideration to the interests of the policyholder in adjusting the loss. If doing this results in premium increases or contraction of future sales, this is simply the price to be borne for honoring the insurer's greater duty of care to the vulnerable policyholder seeking coverage and for providing a better insurance product.[184]

By extension, this analysis requires that the independent intermediary employed by the insurer be subject to the same hierarchy of

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[184] In a recent advertising campaign, State Farm expressly touts its performance in providing coverage as of higher quality while being "about the same price" as other insurers. In what may have been an unfortunate harbinger of the team's 2008-2009 season, one commercial features Seattle Seahawks quarterback Matt Hasselbeck getting pass protection from a group of 80-pound Pop Warner league lineman (representing a Brand X insurer), with the predictable result that he is sacked. This is contrasted with another scene in which a group of gigantic lineman (representing State Farm) provide Hasselbeck with sufficient protection to complete a pass. The ad campaign is a fairly direct attempt by State Farm to sell "service-after-the-sale" (and perhaps solvency as well) in trying to persuade prospective buyers not to select an insurer by premium price alone. This sales pitch from the nation's largest insurer is at least in tension with the *Sanchez*'s courts "lower costs are the greatest good" contention, if not an outright refutation of that contention.

duties and set of obligations imposed on the insurer. Refusing to impose substantially similar burdens on the claims intermediary undermines the effective operation of the insurance market. While one can contend that there is sufficient adjuster discipline because the adjuster must answer to the insurer, this is a weak argument. The insurer hired the adjuster for a reason – to outsource the job of handling claims. Realistically, the insurer will rely heavily on the adjuster's investigation and assessment (unless the insurer is outsourcing the function so that the adjuster can be the insurer's "bad cop," which is an even more troublesome scenario). The adjusters' good or bad conduct will have significant impact on claims decisions, all with relatively little supervision by the insurer. This strongly argues for holding claims intermediaries to the same standards imposed on insurers.

Further, as discussed above, the insurer is not nearly as likely to punish adjuster misconduct as was posited by the *Sanchez* Court. One reason is that adjusters can run de facto interference for the insurer. Far from punishing errant adjusters, insurers may enjoy the degree to which an aggressive anti-coverage, low-payment adjuster increases insurer profits while providing a useful (but immune) foil in the comparatively few cases that result in litigation of any sort, much less bad faith or punitive damages litigation.

In addition, because insurer sales, marketing, underwriting, and claims departments often seem to act without much knowledge or coordination among themselves, there is the practical reality that even a pretty sloppy independent intermediary will continue to be used by the insurer unless something (a) goes really wrong and (b) comes to the attention of the proper person who can hire and fire intermediaries under circumstances where (c) the errant adjuster is not on the whole making money for the insurer. If proposition (c) obtainshappens, the insurer is unlikely to seek indemnification for cases in which the adjuster's misconduct toward a policyholder resulted in insurer liability. Many insurers would view this as simply straining relations with a useful business partner and prefer to seek recompensatione through some informal adjustment of pricing in future claims business.

In much the same way that a hospital may be tempted to turn a lax eye toward malpractice suits against a doctor who performs many procedures and generates considerable revenue, the insurer will most likely not take aggressive action against the adjuster even where the adjuster's attributed misconduct results in the insurer paying a claim, particularly where the claim was one the insurer was required to pay in any event (which is usually the case). Only in cases of where bad faith/punitive damages liability significantly exceeds policy limits is the insurer likely to be very bothered by intermediary error. In short, even the strongest of the public policy rationales of *Sanchez* and similar decisions is unconvincing.

Sanchez is also awash in statements that suggest the court had an underappreciation of the nuances of insurance concepts and insurance in operation. As noted in the extensively quoted passages above, the court seems to favor immunity for intermediaries because it seems them as the analog to mom-and-pop grocery stores under attack from supermarkets. To the *Sanchez* court, any contraction of the business of independent adjusting and any movement toward adjusting by the insurer's own employees is a step in the wrong direction. But just as the supermarket is generally seen as an improvement over the corner grocery store (and remains a superior alternative to 7-Eleven and its counterparts), it might improve insurance adjusting if the small independents were replaced by larger, more professional organizations operated by the insurers themselves.

In addition to turning the concept of privity on its head (so that the absence of contract not only protects the adjuster from a contract-based claim but also makes imposition of tort liability unfair), *Sanchez* also converts the notion of reasonable expectations from a concept generally favorable to policyholders to one favoring adjuster immunity because "[a] new rule would defeat their reasonable expectations."[185]

Further, recognition of "[a]djuster liability would be an empty slate, upon which the courts would have to write a whole new body of ''adjuster liability' law" without the benefit of "contracts devised by knowledgeable and imaginative private parties to give structure to the risks" resulting in years of development of law in the area.[186] This part of *Sanchez* is a little shocking in that it seems to argue that courts should be reluctant to recognize defendant liability simply because this will increase the workload of the courts.

By this rationale, one might argue for complete abolition of all liability irrespective of the question of individual rights and the social benefits of court-imposed liability and enforcement. Or, to cite some less extreme examples from real life, one might note that recognition of rights such as anti-discrimination, desegregation, one person/one vote, arrestee rights and manufacturer liability for unsafe products, all required courts to devote subsequent judicial resources to developing these emerging bodies

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[185] *See* 84 Cal. Rptr. 2d at 803.

[186] *Id.*

of law. But this was never seen by the judiciary as a reason to refrain from doing what the court otherwise viewed as the legally proper thing and recognizing the basic right in question.

Similarly, the court's desire to have "knowledgeable and imaginative private parties"[187] provide guidance begins to make it look all the more as though a main underpinning of *Sanchez* was abdication of the judicial function. Courts have for centuries developed the contours of duty and breach necessary to apply tort law. They hardly need contract draftsman from the insurance or intermediary industries to guide them in fleshing out the contours of claims intermediary liability.

In addition, there is nothing to prevent insurers, intermediaries, or other entities affected by any new rule of liability from doing their own contracting around the new legal regime through indemnity agreements or the like. *Sanchez* wrongly assumes that the announcement of a tort law rule removing absolute immunity for intermediaries would forever freeze the operations of participants in the insurance marketplace. On the contrary, a tort law rule of no adjuster immunity would be, like most legal rules, a default rule to which market participants could adjust (through contract and other means).

Also problematic is *Sanchez*'s deployment of the case law on the question of intermediary immunity. Predictably, *Sanchez* cites several cases illustrative of what it correctly regards as the majority rule, but it makes little effort to grapple with contrary precedent. New Hamphire's 1986 *Morvay*[188] decision, an opinion at loggerheads with much of the *Sanchez* pronouncements, is not even cited. The 1980 Alaska decision of *Continental v. Bayless and Roberts* is cited but given unfairly and deceptively short shrift by *Sanchez*, which characterizes the rather pathbreaking *Bayless* case as "simply "rel[ying] on an earlier Alaska case" imposing liability on an agent.[189]

By contrast, the Oklahoma Court of Appeals opinion in *Brown v. State Farm*,[190] makes considerably more persuasive public policy

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[187] *Id.*

[188] *See* Morvay v. Hanover Ins. Cos., 506 A.2d 333 (N.H. 1986).

[189] *See Sanchez*, 84 Cal. Rptr. 2d at 803.

[190] *See* Brown v. State Farm Fire & Cas. Co., 58 P.3d 217 (Okla. Civ. App. 2002).

arguments in favor of at least permitting adjuster liability. In *Brown*, plaintiffs were homeowners seeking coverage after two March 2000 fires damaged their property, claiming losses of more than $60,000.[191] The insurer retained an independent investigator that "concluded, "without interviewing either Brown or any of the fire-fighters involved, that there was only one fire, and that it resulted from 'the deliberate act of a person or persons'" and that some claimed damage predated the fire.[192] Perhaps unsurprisingly, the investigative report was a significant factor in the insurer's decision to deny the claim.[193]

Brown sued both State Farm and the independent investigator, settling with the insurer and continuing its claim against the adjuster, presumably for losses that were not sufficiently compensated from the funds paid by the insurer in settlement.[194] Thus, *Brown* provides an immediate example that, contrary to the assertions of Sanchez, it may well be practically useful to have liability potentially applicable to more than one entity involved in claim denial. In this sense, the removal of absolute immunity for independent intermediaries can be an effective means of providing more protection, spreading risk more widely, and facilitating greater settlement of disputes.

Comparing the adjuster's situation to that of others who could be liable to reasonably foreseeable third parties, the *Brown* Court saw nothing jarring about removing investigator/adjuster immunity.[195] Because the policyholder presenting a claim to the adjuster is so obviously someone who could be hurt by poor performance of the adjuster's duty, the *Brown* Court had no problem finding that there was adequate foreseeability sufficient to create a tort law duty owed the policyholder by the adjuster.

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[191] *Id.* at 218.

[192] *Id.*

[193] *Id.* (case states that the decision was "based at least in part on this report").

[194] *Id.*

[195] In particular, the court considered attorneys, sellers of intoxicating beverages, and individuals engaged in a love/lust triangle as having duties to those who could reasonably be injured by their conduct, citing Oklahoma case law in support. *See* 58 P.3d at 219-22.

Brown was assisted in its decision by Oklahoma's different law regarding immunity for auditors. Unlike California, which follows the limitations of *Ultramares v. Touche*,[196] Oklahoma had for some time rejected *Ultramares* and embraced the broader liability rule of Restatement §552,[197] at least regarding negligently supplied information.[198] According to the *Brown* Court, it "was reasonable" for the policyholder "to expect that State Farm, through it's [sic] agent JJMA/Cooper, would perform a non-negligent investigation of the fire. Indeed, it is indisputable that 'both the insured and the insurer [had] a stake in the outcome of the investigation.'"[199]

The jurisprudence of adjuster immunity generally suffers from an underappreciation of the degree to which the incentives of insurer and adjuster are insufficiently aligned with those of the policyholder (to whom a duty of good faith is owed) and others to whom tort-like duties of care are logically owed. As discussed above, under the current regime, the insurer can to some extent use the independent adjuster to "do its dirty work" with no liability risk to the adjuster and reduced bad faith and punitive damages risk to the insurer. This potentially creates a huge practical loophole in the law of bad faith that is supposed to provide adequate protection to policyholders. It also can create problems for other participants in insurance markets, as illustrated below. Put simply, without facing liability

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[196] *See* 174 N.E. 441, 447 (N.Y. 1931) (accountants not liable to third parties for damages resulting from poor auditing, which was seen as beach of duty owed the client but not a basis for tort liability to third parties, even those whose reliance on the audit was reasonably foreseeable).

[197] *See, e.g.*, Stroud v. Arthur Andersen & Co., 37 P.3d 783, 793-94 (Okla. 2001).

[198] *See* Restatement (Second) of Torts § 552 (1977):

> One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

[199] *See* 58 P.3d at 222 (citing *Morvay*).

itself, the claims intermediary simply lacks sufficient incentive to engage in an optimal level of care toward policyholder's and others.

Sanchez and other modern cases defending intermediary immunity claim that there already exists adequate incentive for care because of the principal's potential contract claims against an intermediary who errors. As previously discussed, this contention has problems even as a matter of theory. As a matter of empirical evidence, the theory also seems infirm. Although the case reports are not awash in suits against intermediaries, they at least allege some very slipshod and wrongful conduct that should probably never occur if the theory of adequate policing by insurer principals is accurate.

For example, in *Aslakson v. Gallagher Bassett Services, Inc.*,[200] the state Department of Workforce Development retained the defendant as a claims manager and TPA for the state's Uninsured Employers Fund.[201] Although the case focused primarily upon the degree to which the TPA might share the employer's immunity under state workman's compensation law, it is instructive in illustrating the degree to which claims intermediaries can engage in egregious misconduct and the utility of holding them accountable under such circumstances.

Plaintiff worked as a carpenter.[202] In July 1998, he fell 18 feet while working on a pole barn and sustained serious injury.[203] His employer lacked worker's compensation insurance, forcing him to make a claim with the Uninsured Employers Fund in January 2000 (after apparently receiving medical care and other benefits in the interim, the source of which is unclear from the opinion).[204] Despite what seems a clearly work-related serious injury without employee misconduct, the TPA denied the claim.[205] It then required that the worker have in independent medical

[200] 729 N.W.2d 712 (Wis. 2007).

[201] *Id.* at 714.

[202] *Id.* at 715.

[203] *Id.*

[204] *Id.*

[205] *Id.*

examination.[206] The March 2000 exam, while finding lower disability levels than claimed by the worker, confirmed temporary and permanent disability and "clearly entitled the plaintiff to worker's compensation benefits."[207]

But despite repeated requires, the TPA did not pay the benefits, even though its own vocational expert conceded up to a 10 percent loss of earning capacity due to the worker's injuries.[208] As of September 2001, benefits remained unpaid.[209] The worker pursued administrative relief, which resulted in an administrative law judge (ALJ) order that the TPA pay approximately $100,000.[210] But the TPA released only $4,000 from the state Fund and "refused to pay the remainder of the award," forcing the injured worker to seek additional review.[211] In May 2002, the state's Labor and Industry Review Commission adopted the ALJ's findings.[212] Rather than pay, the TPA sought judicial review, which resulted in court affirmance of the administrative decision in December 2002.[213] The TPA again refused to pay and sought further review, resulting in a September 2003 decision in favor of the worker.[214] "Only then did [the TPA] finally pay the balance of the plaintiff's claim."[215]

Although finally paid, the worker was not mollified, and brought a bad faith action against the state Fund and the TPA, claiming (with

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[206] *Aslakson,* 729 N.W.2d at 715-16.

[207] *Id.* at 716.

[208] *Id.*

[209] *Id.*

[210] *Id.*

[211] *Id.*

[212] *Aslakson,* 729 N.W.2d at 716..

[213] *Id.*

[214] *Id.*

[215] *Id.*

seemingly good reason in light of the case history) that there was never any reasonable basis for contesting the claimed benefits (or at least not 96% of them) and "that the appeals were taken merely to delay payment of rightfully owed benefits."[216] The Fund and TPA defended on grounds of immunity under the state Worker's Compensation Act, a defense the trial court rejected as to the TPA.[217] The intermediate appellate court reversed, but the Wisconsin Supreme Court, in a persuasive opinion centered primarily on statutory construction, ruled that the state's worker's compensation law did not immunize the TPA and that plaintiff's bad faith action could proceed.[218]

Apparently, there was no question under Wisconsin law that, in the absence of statutory immunity, the claim could be brought against the TPA notwithstanding lack of privity of contract and the TPA's status as a disclosed agent of the Fund.[219] The Court viewed the claim as permissible (in the absence of worker's compensation immunity) under Wis. Stat. § 102.18(1)(b) "which provides a penalty for bad faith conduct" in worker's comp claims.[220] Consequently, *Aslakson* is not, strictly speaking, a case either embracing or rejecting common law immunity for claims intermediaries. In spirit, however, *Aslakson* is more aligned with cases rejecting intermediary immunity than with cases following the historical rule.

More important for purposes of this section, *Aslakson* illustrates the degree to which claims intermediaries can engage in pretty outrageous conduct and that they, in the absence of liability, have relatively little incentive to treat claimants fairly. Recall that the TPA in question was taking the position – one rejected by an ALJ, an administrative review board, and a trial court – that a carpenter could fall 18 feet and suffer only $4,000 worth of permanent partial injury. Although the intermediate appellate court mysteriously granted more leeway to the TPA, the

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[216] *Id.*

[217] *Id.*

[218] *Aslakson,*729 N.W.2d at 717, 728.

[219] *See Id.* at 719.

[220] *Id.*

Wisconsin Supreme Court overwhelmingly agreed with the assessment of the ALJ, review board, and trial judge.

The bad faith claim in *Aslakson* centered on the TPA's recalcitrance in prosecuting appeals, one can make a strong argument that even its initial position forcing the ALJ decision constituted bad faith. The TPA's own vocational expert concluded that Mr. Aslakson had incurred a 10 percent decline in earning capacity because of the injuries from the fall. Even a lazy or bad carpenter will earn a lot more than $40,000 in what remains of working life but the TPA was willing to pay only $4,000 after the ALJ decision, and refused to pay anything prior to the ALJ order. On its face, the TPA's conduct looks unreasonable, yet the TPA was unwilling to give apt concern to the worker's interest and was unwilling to re-evaluate its hostile stance in light of mounting factors favoring payment.[221]

Even if Asklakson had been a white collar worker and not suffered neurological impairment in the fall, the TPA's assessment would have been extreme. Applied to a claimant whose livelihood depends on his physical health, strength, endurance and dexterity, the TPA position seems ridiculous on its face. One need not be a cynic to perceive the TPA's conduct as merely running out the clock on the claimant in hopes of either forcing a settlement at a reduced amount or allowing the further investment income to the Fund.

As discussed above, insurers are often attracted to TPAs who engage in such conduct because it can be profit-enhancing for the insurer without the carrier itself sullying its hands through directly connected bad faith treatment of the policyholder. Under the traditional rule, the TPA acts with impunity toward the policyholder/insured/claimant, no matter how unreasonable or evil its conduct.

In the context of the *Aslakson* case itself, the incentive structure is even worse because the state Fund is immune and lacks incentive to punish the TPA for misconduct since the Fund will not suffer any adverse conduct from the TPA's wrongdoing – even though the Fund may enjoy economic gain because of that wrongdoing. If the TPA is also immune, the victim is left without remedy. Although the worker's compensation or sovereign

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[221] In contrast to the TPA position, the ALJ decision seems reasonable on its face. A carpenter of relatively young age could easily earn $1 million in gross income over his remaining working life. Ten percent of that amount produces the $100,000 award. Although a significant sum, it does not facially seem misaligned with the facts of the case.

immunity situations give particular illustration to the problems created by intermediary immunity, private insurance presents much the same situation with only the salve that the victim will usually have at least some claim against the insurer as principal.

Although the primary victims of claims intermediary error (or at least the victims without recompense)[222] are policyholders and claimants seeking recovery, insurers who are not the principals of an intermediary may on occasion suffer harm due to the intermediary's misconduct. In such cases, the rule of intermediary immunity also needlessly shields intermediaries and too greatly reduces the intermediary's incentive to take adequate care and to make a reasonable assessment of a claims situation. This imposes costs not only on the affected insurers, policyholders, and claimants but also can impose substantial externalized costs on the judicial system and society.

A fascinating (but one hopes rare) illustration of the far-reaching mischief of intermediary immunity is a case that began as *First Specialty Insurance Corporation v. Ward North American Holding, Inc.*[223] and ended as *First Specialty Insurance Corporation v. Novapro Risk Solutions, LP.*[224] The case started out simply enough with a barroom brawl in which one of the patrons was severely injured.[225] Actually, it was more of an unprovoked attack rather than an escalating feud between patrons.[226] The attacking group had set upon another patron earlier in the evening, inflicting significant but less severe injury and had not been immediately ejected from the premises or arrested, which is the normal accepted practice in such cases. The more severely injured victim thus had a pretty

[222] Insurers can of course be harmed by intermediary error or misconduct. However, as principals with contract relations with the intermediary, an injured insurer will have at least breach of contract remedies and perhaps other avenues of relief as well.

[223] No. 04-2359-JWL, 2004 U.S. Dist. LEXIS 23726 (D. Kan. Nov. 22, 2004).

[224] 468 F. Supp. 2d 1321 (D. Kan. 2007).

[225] *Id.* at 1323, 1332-33.

[226] *Id.*

good premises liability claim against the bar and consequently sued. The bar nightclub submitted the claim to its insurance agent.[227]

Simple case, right? On its face, the matter seemed one to settle for some reasonably serious money fairly quickly so that the plaintiff would not get before a jury that could find him afflicted with seven figures worth of injury (his face had been crushed and had to be extensively rebuilt with metal plates and plaintiff, a school teacher in his thirties, had also suffered significant cognitive injury).[228] But the actions of the first TPA took the case outside the realm of the simple.

The incident and injury took place in April 2000.[229] In Summer 2000, the bar's general liability insurer changed from a Lloyd's group to First Specialty.[230] Plaintiff counsel's February 2001 notice and demand letter did not set forth the date of the incident.[231] Suit was filed in October 2001 and the copy passed along was not clear regarding the April date of the incident.[232] The First Specialty TPA (Ward North American) incorrectly assumed that the injury took place in April 2001, during the First Specialty coverage period, rather than April 2000 during the Lloyd's coverage period. The First Specialty TPA (Ward, which subsequently became NovaPro) retained defense counsel, who represented the bar through arbitration, demanding trial de novo after a $175,000 award.[233] Finally, in mid-March 2003, the First Specialty TPA discovered the mistake and notified the apt Lloyd's managing general agent (Mavon,

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[227] *Id.* at 1332-33 ("no question" plaintiff was "very seriously injured" and that "the $445,000 settlement ultimately reached was reasonable, that it was the result of good faith negotiations, and that [circumstances of the case] did not . . . result in an 'over-payment' to [plaintiff].").

[228] *Id.*

[229] First Specialty Insurance Corporation, 468 F. Supp. 2d at 1323.

[230] *Id.*

[231] *Id.*

[232] *Id.* at 1323-24.

[233] *Id.* at 1324.

which was the Lloyd's independent contractor for claim notice purposes) who in turn alerted the Lloyd's TPA, Elliston.[234]

At this juncture, the situation was unfortunate on many levels. The first TPA's error had resulted in the wrong insurer expending defense costs. But the defense to date had been a relatively light one, without substantial attorney time spent fighting the arbitration or conducting discovery.[235]

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[234] *Id.*

[235] The minimalist nature of the defense provided by First Specialty's chosen counsel became a major issue in the case in that Elliston/Lloyd's took the position that not only was notice of the claim late but that they had been prejudiced by the late notice because the underlying tort claim was so far along and had not been defended with sufficient aggressiveness. This type of late notice/prejudice defense, although a staple of insurance law (and a frequent favorite of insurers looking for reasons not to pay a claim), is a particularly hard one to make in New Jersey. The state's arguably leading case on the matter rejected the defense even though the insurer did not receive notice of the matter until *after* a default judgment had been obtained against the policyholder. *See* Morales v. Nat'l Grange Mut. Ins. Co., 423 A.2d 325, 327 (1980); *accord* Hatco Corp. v. W.R. Grace & Co., 801 F. Supp. 1334, 1372-73 (D.N.J. 1992) (six-year delay in notice not sufficient to cause actual prejudice to insurer); *see also* Cooper v. GEICO Ins. Co., 237 A.2d 870, 873-74 (1968) (adopting appreciable prejudice test and notice-prejudice rule as state law); *see also* Molyneaux v. Molyneaux, 553 A.2d 49, 51 (1989) (reaffirming state law on the point). In one case rather similar to the instant matter where the delay resulted from a misunderstanding that had the wrong insurer initially defending the matter, the late notice defense of the right insurer was rejected due to an absence of prejudice. *See* Vornado Inc. v. Liberty Mut. Ins. Co., 254 A.2d 325, 328-29 (1969).

Winning a late notice defense in New Jersey is an uphill battle even with compelling facts. Only if the defense lawyer used by First Specialty had done horrendous work (or non-work) was this defense likely to succeed. In reviewing the matter after hearing evidence at trial, the court:

> . . . came away from trial with the distinct impression that, at best, Ward did average or "C" work on the [underlying plaintiff's] claim *before* suit was filed. The record is very thin as to whether the way in which the [plaintiff's] claim was handled by Ward was materially better or worse than other claims it was adjusting for First Specialty and other insurers. Nevertheless, *after* suit was filed in Ocotober 2001, the record suggests that Ward and [defense attorney Stephen] Wellinghorst together took reasonable actions to investigate and defend the [plaintiff's] claim.

[T]he court formed the impression that Wellinghorst's skills as a trial lawyer are generally on par to those actually exhibited by the fine lawyers who represented First Specialty, Lloyd's and Ward in the instant coverage litigation.

The court further finds that Wellinghorst used the above-described skills to do a reasonable and competent job in defending [the policyholder] in a case that presented very few, if any, viable defense opportunities on the primary issues of liability and damages. The court, however, has no illusions that Wellinghorst did an outstanding job, let alone a "perfect" job, with his defense of [the policyholder].

[However,] it was Wellinghorst who discovered Ward's mistake with regard to the date of loss and policy coverage issue. He could have remained silent upon that discovery in an effort to avoid the instant litigation. But instead he did the right thing by notifying Ward. *See First Specialty v. Novapro*, 468 F. Supp. 2d at 1329-30 (emphasis in original).

With the exception of the statement that Ward "could have remained silent" on the matter, the court's assessment seems unquestionably correct. I was retained by First Specialty as an expert witness in the case (more on that below) and have reviewed the record in the underlying tort matter as well as the coverage dispute. The court's assessment of the litigation reality of the matter is close to unassailable. Attorney Wellinghorst and Ward/First Specialty did not mount a scorched earth defense of the barroom brawl claim but did an adequate job. More important, a scorched earth defense would have only needlessly wasted resources and potentially exposed the policyholder to an excess verdict. The case was a strong one for plaintiff, with essentially no question regarding policyholder liability and the essential magnitude of plaintiff's injuries.

The case didn't need aggressive defense but instead required aggressive settlement efforts to resolve the matter at a figure that was sufficiently generous to eliminate the claim without overpaying plaintiff. Wellinghorst, Ward, and First Specialty in my view (and the court's) accomplished this with almost flying colors. A $435,000 settlement is not necessarily a bargain for the insurer, but is a more than reasonable amount in a case with no good liability defenses and a young plaintiff with substantial medical bills, a year of missed work, permanent brain damage, and permanent facial disfigurement. There was also significant testimony putting this settlement in range of similar cases in the locality in question (Atlantic County and the New Jersey Shore). One need not be a Bon Jovi devotee (the barroom brawl occurred in Sayreville, the singer's home town) to realize that bodily injury verdicts in a relatively urbanized part of the East Coast are frequently substantial, often reaching seven figures. If the case had been venued in the rural West, Lloyd's might have had some ground for objecting to the size of the settlement but this argument was in my view unpersuasive as a matter of law in light of the actual trial location and the unquestioned seriousness of the injuries to plaintiff.

But on the issue of attorney Wellinghorst's obligations, the court's assessment was hopefully only a rhetorical tangent rather than a serious pronouncement about

Now trial was scheduled for late summer 2003. Elliston complained that it was now too late and that it (and more important) Lloyd's had been prejudiced by the late notice and need not cover the matter even though the claim clearly arose during the Lloyd's coverage period. The argument was astoundingly weak in light of applicable New Jersey law[236] and the

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attorney professional responsibility. A defense attorney retained by an insurer or claims intermediary owes a duty of candor to the insurer. Although the rights of the policyholder defendant as primary client of the attorney are greater and take precedence in the event of conflict, the attorney generally has no right to remain silent when it discovers information that may affect the insurer's rights as a party that contracted to provide legal services to the policyholder. In this case, because the policyholder had insurance with Lloyd's during the time of the brawl, there was no policyholder-insurer conflict sufficient to permit defense counsel to withhold from the insurer the important information regarding the actual date of loss. If First Specialty had attempted to use the information to abandon its policyholder on the eve of trial, Attorney Wellinghorst would have presumably advised the insurer of the policyholder's rights and a possible bad faith claim against the insurer. But in my view, Wellinghorst had no discretion to withhold the information from Ward/First Specialty and would have been subject to breach of contract or legal malpractice liability (in states that consider the insurer to be a "client" of the defense attorney) had he done so.

[236] *See supra* note 165. Elliston and Lloyd's also argued, based on New Jersey's "Best Practices" rules, that the time for conducting discovery had passed and that it was now too late to conduct discovery or other litigation activity that could cure the alleged inadequacies of the defense prior to their notification. The "Best Practices" rules set discovery deadlines for particular types of cases but, in practice, appear to be as malleable as any other discovery deadlines. Discovery in the barroom brawl case was "technically set to end on September 10, 2002" months before notification to Elliston/Lloyds but:

> [T]he evidence at trial was essentially uncontroverted that the parties continued to conduct discovery through the summer of 2003 [the eve of trial], including depositions of [plaintiff and three other arguably important witnesses]. Despite Lloyd's speculation, there simply is no credible evidence in the record to support the notion that [plaintiff's counsel or the New Jersey trial court] would have sought to strictly enforce Best Practices had Lloyd's decided to become involved in [defense] in the spring and summer of 2003. Nor is there any credible evidence in the record that [plaintiff counsel] or the presiding judge would have moved at trial to strike any discovery taken on behalf of [the defendant policyholder] after the Best Practices discovery deadline."

practical realities of trial in every jurisdiction, where custom and practice as well as the discretion accorded under the rules auger in favor of granting additional discovery or postponement of trial where a party or counsel is brought into a case late in the day.

The Elliston/Lloyd's complaint about prejudice also appears to have been mere pretext in that Elliston essentially articulated the defense and sat on its hands rather than at least exploring the defense and settlement options. Although Elliston was not in a great position, it made essentially no effort to salvage the situation. It did not seek a postponement of trial. It did not retain counsel or assume control of the case with existing defense counsel. It did not seek to conduct additional investigation or discovery. Most important, Elliston made no effort to assess the liability exposure presented by the case or to settle the matter on reasonable terms.[237]

Instead, Elliston and Lloyd's refused to take over the case, leaving First Specialty holding the metaphorical bag. If First Specialty had stopped defending the bar and trying to settle the case down the home stretch, it would have been vulnerable to serious allegations of bad faith by the policyholder.[238] Making what it thought was the best of a bad situation,

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See First Specialty v. Novapro, 468 F.Supp.2d at 1332. Because it is the insurer's burden to show prejudice from late notice, the absence of this evidence prior to trial would logically have supported summary judgment for First Specialty on this issue. Merely by permitting trial on this point, the court arguably did Elliston/Lloyd's a favor and gave the "discovery deadline has passed" defense more regard than it deserved.

[237] *See Id.* at 1335:

> Clearly, Lloyd's was placed in a less than ideal position by the late notice of the Femia claim. The evidence at trial, however, simply does not support the assertion that Lloyd's irretrievably lost substantial rights as a result of late notice of the [barroom brawl] claim. Indeed, the evidence strongly suggests that, had Elliston *actively* intervened in March 2003, and it definitely could have done so under a reservation of rights, it still would have been able to investigate, defend, and/or settle the [underlying] case without significant impediment.

Id.

[238] *See id.* at 1339 (First Specialty "was essentially 'stuck between a rock and a hard place'" because of duties to policyholder, even if claim did not fall within First Specialty policy period). *See, e.g.*, Griggs v. Bertram, 443 A.2d 163, 167

First Specialty conducted additional discovery and analysis (making up in significant degree for the admittedly minimalist defense it had conducted prior to that time) and settled the case in a range deemed appropriate by seasoned counsel and ultimately by the court in the ensuring litigation wrought by the mistakes of the two claims intermediaries (Ward and Elliston).[239]

An old adage of the radio business is that "if you don't have time to do it right the first time, you'll never have time to fix it." Although not literally true, the saying, like the better known "stitch in time saves nine" nicely captures the higher remedial cost that is created by errors at the outset. If Ward had correctly realized that the incident was not within the First Specialty coverage period, the claim would have gone to Elliston and Lloyd's, who could have defended and settled (or not settled) the case as seen fit. Instead, the matter went from largely simple and routine to more complex and unusual. Having paid $445,000 to settle the bodily injury claim plus defense costs, First Specialty wanted reimbursement from the insurer that should have handled the claim from the outset.[240]

Although Elliston's errors as the Lloyd's intermediary are less obviously fumbling than those of Ward, they were significant. Although Elliston (and Lloyd's) received notice later than desired, there was still a significant amount of time to take over the case and defend or settle it to its liking rather than whining that it was stuck with the alleged claims handling errors of First Specialty and defense counsel. Instead of acting reasonably, Elliston postured. For example, it claimed that further discovery was unavailable due to the close of the discovery period without even trying to obtain a reopening or an agreement with opposing counsel to conduct depositions, physical examinations, or the like. As nearly every litigator knows, most anything can be done by agreement of counsel, which is not normally unreasonably withheld because courts are generally empowered to grant these extensions and exceptions unless the matter is one of the few "jurisdictional" deadlines over which courts have no discretion.

(1982) (carrier beginning defense without reservation of rights estopped from denying coverage). Because of the error of its TPA, First Specialty understandably viewed the claim as falling clearly within its coverage and did not defend under a reservation of rights.

[239] *See* First Specialty v. Novapro, 468 F. Supp. 2d at 1338-41.

[240] *See id.* at 1323-25 (describing background of litigation).

Elliston's intransigence could have been simple laziness or negligence. It could also have been (and in my view was) tactical posturing designed to keep First Specialty "stuck" with the coverage obligation that rightfully belonged to Lloyd's and for which Lloyd's (not First Specialty) had received a premium. It is more than possible that Elliston was not dropping the claims handling handoff because of incompetence or sloth but because it was doing the bidding of Lloyd's in trying to paint First Specialty into a corner from which it could not escape through using the pretextual excuse that is was now "too late" for Elliston to pick up the claim and that Lloyd's was prejudiced in its ability to defend and cover the matter.

All of this brought about an additional lawsuit by First Specialty seeking reimbursement from Lloyd's based on subrogation and unjust enrichment. First Specialty also sued its TPA (which had blown it so badly on the actual date of the plaintiff's injury at the bar) and sued Elliston as well as Lloyd's. An unfortunate but hardly remarkable barroom assault that probably should have resulted in no significant litigation became a battle royal that resulted in a second lawsuit (in addition to the injured patron's bodily injury/inadequate security claim), extensive pretrial discovery, retention of experts,[241] four pretrial judicial opinio[242] a week-

[241] *See id.* at 1336-37 (in which the court makes "specific credibility findings" about various witnesses, including expert witnesses, even though the decision was not, according to the court, based on any expert testimony). As noted above, I was retained as an expert for First Specialty, as was former U.S. District Court Judge Curtis Meanor of the District of New Jersey. Lloyd's retained George Kenney, a prominent practitioner and co-author of New Jersey Insurance law. *See* GEORGE KENNY & FRANK A. LATTEL, NEW JERSEY INSURANCE LAW (2d ed. 1993).

[242] *See* First Specialty Ins. Corp. v. Ward North America Holdings, Inc., 2004 WL 2672833, at *1 (D. Kan. Nov. 22, 2004) (denying Lloyd's motion for change of venue to New Jersey); First Specialty Ins. Corp. v. Novapro Risk Solutions, LP, 468 F. Supp.2d 1321, 1336-37 (D. Kan. 2007) (referring to earlier pretrial ruling rejecting *Daubert* challenge to proffered expert that resulted in written opinion not available in LexisNexis database); *see also* First Specialty Ins. Corp. v. Ward North America Holdings, Inc., 2005 U.S. Dist. LEXIS 33250, at *3 (D. Kan. Dec. 15, 2005) (denying St. Paul Travelers motion to dismiss without prejudice on technical grounds that submission of affidavit converted it to summary judgment motion that was premature); First Specialty Ins. Corp. v. Ward North America Holdings, Inc., 2005 WL 3447708, at *1 (D. Kan. Dec. 15, 2005) (granting Elliston's motion to dismiss) (all opinions by District Judge John W. Lungstrum); First Specialty Ins. Corp. v. Ward North America Holdings, Inc 2006 U.S. Dist.

long trial and a 20-page bench opinion.[243] The collective expense of the enterprise was hundreds of thousands spent on out-of-pocket disputing costs and at least tens of thousands of dollars worth of judicial resources (by three different judges and their staffs) shouldered by taxpayers even if not formally billed in itemized fashion.

And who paid for this train wreck? The claims indermediaries who caused and exacerbated it? Hardly. In its findings of fact and conclusions of law, the court found that Ward (First Specialty's administrator) could not be liable in negligence unless there was a finding of prejudice to either insurer as a result of late notice. Finding no prejudice, the court granted Ward's motion for judgment as a matter of law.[244] Elliston (the Lloyd's administrator) did even better in that it was dismissed from the case a year earlier when the court, following the traditional rule on intermediary liability, ruled that First Specialty had no claim against Elliston because there was no contract between First Specialty and Elliston.[245]

LEXIS 60219 (D. Kan., Aug. 22, 2006) (issuing protective order) (by Magistrate Judge Keith G. Sebelius). There were also judicial rulings that are not generally available on online.

[243] *See generally First Specialty v. Novapro,* 468 F. Supp. 2d 1321 (discussing findings of fact and conclusions of law by Magistrate Judge James P. O'Hara).

[244] *See id.* at 1343.

[245] *See First Specialty v. Ward,* 2005 WL 3447708, at *1-2 (Kan. Dec. 15, 2005) ("First Specialty asserts the breach of the duty of good faith and fair dealing against Elliston without asserting any contractual relationship with Elliston. The claim for bad faith in denying an insurance claim 'is best understood as one that sounds in contract.'") (citing Kansas precedent and Charleston Dry Cleaners & Laundry, Inc. v. Zurich American Ins. Co., 586 S.E.2d 586, 588 (S.C. 2003) which was discussed *supra* notes 102-103 and accompanying text) (citation omitted); *see also* Wolverton v. Bullock, 35 F. Supp. 2d 1278, 1280-81 (D. Kan. 1998). The *First Specialty* Court echoed the *Charleston Dry Cleaners* sentiment that the "duty of good faith arising under the contract does not extend to a person who is not a party to the insurance contract. Thus, no bad faith claim can be brought against an independent adjuster or independent adjusting company." *See First Specialty v. Ward,* 2005 LEXIS 33247 at *2, quoting *Charleston Dry Cleaners.*

In addition, the court rejected the claim that there was any special relationship with Elliston that would support a breach of fiduciary duty claim. *See id.* at *7 ("First Specialty is not the insured in this case, and even more damaging to its claim, Elliston is not the insurer. The parties are completely attenuated, and

At the end of this litigation day, then, two entities substantially responsible for a lot of wasted time, energy and money escaped liability, at least judicially imposed liability. At a minimum, this seems inconsistent with the basic notion that a rational legal system should create sufficient incentives for adequate care and hold persons and entities accountable when their errors cause injury to others who might reasonably foreseeably suffer such injury.

One response to this concern and to my criticism of intermediary immunity to third parties is that the parties who do have contractual relations with the intermediaries will have a cause of action against the errant intermediary, thus providing adequate deterrence and compensation even though the third party will not be the instrument of that deterrence and compensation. But cases like *First Specialty* refute this contention on both legal and practical grounds.

First the legal grounds. The federal trial court ruled that Ward, the administrator that was too dense to realize that it had improperly saddled its principal with coverage responsibilities, was not liable to the principal because the principal was ultimately able to get reimbursed for most of the

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accordingly, First Specialty cannot assert any breach of fiduciary duty. Like the claim for good faith and fair dealing, the claim for breach of a fiduciary entirely turns upon a contract between the parties." With no contract, First Specialty has no claim.") (citation omitted). The court's conclusion that the parties are "completely attenuated" is wrong. They may not have been contractually linked, but there are only a couple degrees of separation between them. Complete attenuation implies no logical ties whatsoever. On the contrary, it is more than a little likely and foreseeable that two insurers and their intermediaries might become involved in a claim against their common policyholder. For example, if the barroom brawl had happened at midnight on the day on which the policy periods changes, these parties could have been in dispute as to coverage and claims handling obligations even without any misfeasance by either claims administrator.

With the benefit of 20-20 hindsight, one might also chide First Specialty counsel for not formally making a negligence claim against Elliston, the theory being that although Elliston might not be a "fiduciary" to First Specialty in light of its greater loyalty to (and contract with) Lloyd's, Elliston at least had basic tort-like duties to First Specialty and others reasonably foreseen as affected by its handling of the claim. Elliston was actually and constructively aware that by failing to pick up the defense and handling of the barroom brawl claim it was putting First Specialty in a position where it had to protect the Lloyd's policyholder even though the loss was not the contractual responsibility of First Specialty and that this would impose considerable costs on First Specialty, costs that could only be recouped if First Specialty assumed the burden of settlement.

costs by Lloyd's once it was found that Lloyd's was not prejudiced by the delay in receiving notice of the matter. First Specialty "conceded" this "during trial," which may have been good judicial politics in that it made the insurer look less greedy and reduced the adjudicative burden on the court. But was it right under the law – and should the court have accepted this concession even in an adversary system where parties are largely free to drop claims for any reason?

Although First Specialty essentially gave up on its negligence claim against Ward by taking the position that it was fully compensated if it could prevail against Lloyd's, First Specialty's legal generosity and the court's summary disposition of the negligence claim is not very persuasive. Without doubt, Ward was negligent and negligence of this type also breach of contract as well as inflicting reasonably foreseeable injury upon an entity to which Ward owed clear duties of care and minimal competence. Ward's negligence and breach of contract entitled First Specialty to relief and payment of apt damages.

Even if a successful action against Lloyd's largely made First Specialty whole, there undoubtedly was lost time and productivity inflicted on First Specialty because of the Ward's error. Logically, at least some of this injury remained uncompensated from the judgment against Lloyd's. If nothing else, it appears from the court's judgment that First Specialty shouldered all of its counsel fees in prosecuting its subrogation and unjust enrichment claim. At the end of the day, then, we see a situation in which even the principal of an insurance intermediary is not getting relief against the intermediary even in a case of egregious error.

Now, the practical grounds. The other intermediary, Elliston, of course was in a contract relationship with its principal, Lloyd's. The errors of Elliston arguably inflicted injury upon Lloyd's, unless Lloyd's was calling all shots regarding the barroom brawl claim and therefore removing any discretion. If Lloyd's was calling the shots, presumably there was no breach of contract by Elliston. But such a situation illustrates the unwisdom of the traditional rule. If Elliston were subject to a liability claim by First Specialty, it logically would have made Elliston think twice about blinding taking orders from its principal to do nothing to salvage the claims handling situation when it received notice of the problem.

An intermediary facing potential tort liability is more likely to exercise independent judgment that might save all concerned needless injury, aggravation, and litigation. If instead the poor decision to refuse to take over the claim was really Elliston's decision, it proved a costly one to Lloyd's. Under the theory underlying the majority rule protecting intermediaries from liability to third parties, one would expect the principal to sue the errant intermediary. However, it appears that Lloyd's has made no such claim against Elliston.

After the dust of the *First Specialty* litigation settled, it appears that neither intermediary (Ward nor Elliston) was forced to accept responsibility for pretty poor performance of its duties to its principals and the duties I argue they have to third parties. In this case, it is hard to get too emotional about the result. First Specialty is a commercial entity of some wealth that could have survived even it had not been able to recover against Lloyd's. Having recovered, it was not greatly harmed by the errors of Ward and Elliston even though it in my view was far from made whole. Likewise, Lloyd's syndicates are unlikely to suffer substantial injury due to isolated errors in claims adjustment or litigation.

More disturbing is the prospect that the errors of the intermediaries could have resulted in substantial harm to the policyholder or the claimant in situations like this. For example, the late notice and Elliston's refusal to accept responsibility (and the manner in which the intermediary errors shaped insurer positions) could have created a situation in which the policyholder was left without a defense or subject to a judgment in excess of the policy limits. The claimant could have been put in a situation requiring years of litigation simply to get compensation for what were undeniably serious injuries resulting from pretty clear policyholder negligence that was subject to liability insurance coverage. None of these are good possibilities. Fortunately, the worse was averted in spite of the unreasonable legal deference accorded to claims intermediaries who turned in very defective performances of their basic tasks. The *First Specialty* litigation, however intellectually interesting, was a huge waste of resources largely due to intermediary error. This hardly provides a persuasive brief for clinging to the historical rule of intermediary immunity.

Reviewing the *First Specialty* wreckage, one might recall the public policy argument made in favor of the general rule (most prominently in cases like *Sanchez*, *Meineke* and *Hamill*)[246] positing that imposing liability on intermediaries would be bad because it would move more of the claims function back in house to the insurers or raise prices for basic adjusting services. To that argument, I ask why this would be a problem. In-house claims adjusters surely could not have done worse than Ward and Elliston. And if the specter of liability results in an increase in adjuster fees, this might be a penny well paid to reduce the pound-foolishness of independent contractor intermediaries who cannot even put a loss in the

[246] *See supra* notes 101-141 and accompanying text.

right policy period and that are unable to pick up defense and settlement of a straight-forward assault case months before trial. Although the cases are not legion and the problem is hardly law's most pressing, one cannot help but wonder why the judiciary strains so hard to protect claims intermediaries under these circumstances.

IV. THE ANALYTICAL AND PRACTICAL ADVANTAGES OF REMOVING BLANKET IMMUNITY FOR CLAIMS INTERMEDIARIES

A. REVISITING DOCTRINE: THE AGENT AS TORTFEASOR

The privity and disclosed principals doctrines, despite their historical pedigree, have always rested on a relatively weak foundation. The notion that a contractual relationship is required to grant one rights vis-à-vis other social actors was never as broad or absolute as its defenders maintained. Even in the absence of contract, social actors have certain social responsibilities if placed in situations where their behavior can cause harm to others. The legal system acknowledges this, of course, through a vast body of tort law in which actors are held to have duties toward others, often even total strangers. Seen in this light, one can argue that the old-fashioned citadel of privity, which most famously collapsed in product liability law,[247] was always overreaching in its quest to immunize defendants and limit the reach of tort law. Many of the traditional lack-of-privity decisions tacitly but mistakenly assumed that there were no rights at all in the absence of formal contract rights. These courts simply acted as if tort law rights were beyond realistic consideration.[248] As again revealed most clearly in the product liability context, there were always strong reasons to impose tort liability upon certain conduct with a sufficiently close connection to foreseeable injury to certain parties once it was recognized that the absence of a contract was not disqualifying.

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[247] *See supra* notes 9-12 and accompanying text (discussing *MacPherson v. Buick* and fall of the citadel of privity in product liability matters).

[248] *See supra* notes 101-141 and accompanying text (citing cases immunizing intermediaries on lack-of-privity grounds, expressly or implicitly finding that without contract-based rights, third parties had no legal liability rights against intermediaries).

In effect, courts were mixing apples and oranges by concluding that the mere absence of a contract precluded legal relief on other grounds. Often they were aided and abetted by plaintiffs' counsel who, perhaps having stars in their eyes about potential punitive damages awards, bet all their litigation chips on seeking to make bad faith claims against intermediaries and overlooked the compelling logic of holding a claims adjuster accountable in tort, as would be a passing driver or machinery operator.

Applied to claims intermediaries, the logic of tort law unfettered from a contract-based limitation is compelling. The very nature of the claims process and the intermediaries' role should be recognized as creating at least some duties of at least modest care toward claimants and policyholders. Both are in a vulnerable position relative to the insurer and adjuster. Failure of the adjuster to act in an honest, fair, objectively reasonable manner is almost certain to cause at least some harm in the disposition of the claim.

In some instances, the harm will only be the relatively minor problem of delay or perhaps some quibbling over relatively small amounts of money, insistence on nit-picking documentation, or similar wrongs, that despite resulting from adjuster misconduct, are unlikely to result in litigation. But in other instances, adjuster error can result in substantial delay, dramatic underpayment, or outright denial – all of which may impose not only ordinary breach-of-contract type harms but may also give rise to substantial consequential damages, perhaps even significant physical and mental injury to policyholders or others. In these latter types of cases, there is no reason not to hold claims intermediaries accountable for their actions.

In addition, the traditional agent immunity rule in disclosed principal cases has always been in some tension not only with basic tort law concepts (and jurisprudential or philosophical notions of justice, responsibility and accountability) but also with other aspects of agency law. For example, even agents for disclosed principals may be liable to those with whom they negotiate if they have misled the third party as to the agent's authority.[249] Although this traditional form of agent liability is premised more on contract grounds (i.e., the agent misrepresenting his

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[249] *See* HAROLD GILL REUSCHLEIN & WILLIAM A. GREGORY, THE LAW OF AGENCY AND PARTNERSHIP §§ 119-121 (2d edition); *see, e.g.*, Schafer v. Fraser, 290 P.2d 190 (1955).

authority has induced reasonable reliance that causes detriment to the third party), it nonetheless provides strong historical support for the proposition that where agents take volitional acts that cause injury to third parties, liability is appropriate.[250]

In addition, notwithstanding the protection historically bestowed by the disclosed principal rule, "[a]n innocent agent who is responding to the orders of a principal may be liable without fault for torts such as trespass to land, conversion and defamation."[251] In addition,

> [f]or other torts the agent is liable only if it proved that he possessed the requisite state of mind. Illustrative of such torts are deceit, malicious prosecution, interference with business and negligence. Under no circumstances, except where he is acting to protect an interest of the principal, is the fact that the agent is acting within the scope of employment or the command of the principal a defense. . . . [T]he liabilities of the agent may be increased simply because he has asserted control over the property or other agents of his principal or because he has presumed to do something which, if properly accomplished, would have prevented harm to others.[252]

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[250] And in misrepresentation of authority cases, the damages can be significant. *See id.* at § 120 (damages may include net value of transaction that would have taken place if authority had been represented, plus counsel fees)(citing cases from the 1950s). *See also id.* § 125 ("mere fact that an agent acts on account of his principal does not exonerate him of liability for misrepresentations he makes to a third party).

[251] *See* REUSCHLEIN & GREGORY, *supra* note 249, at § 124 (citations, including two cases from the 19th Century, omitted).

[252] *See* REUSCHLEIN & GREGORY, *supra* note 249, at § 124 (citations omitted). *See also* Leathers v. Aetna Cas. & Sur. Co., 500 So. 2d 451, 453 (Miss. 1986)("[O]ur general rule in tort is that the agent or servant, the one whose conduct has rendered his principal liable, [also] has individual liability to the plaintiff."); *see generally* WARREN SEAVEY, STUDIES IN AGENCY 1 (1949); *see generally* Warren Seavey, *Liability of an Agent in Tort*, 1 SOUTHERN L.Q. 16 (1916).

Most important for purposes of assessing claims adjuster exposure, "[t]he fact that one acts as an agent does not absolve him from liability for his negligence."[253]

Particularly relevant is that "[s]ome jurisdictions will hold the agent liable if the agent has undertaken the sole and complete control and management of the principal's premises. In such circumstances, the agent's omission is an act of misfeasance, rather than mere nonfeasance" although "the agent is not liable for the negligence of the principal" in the absence of the agent's own negligence.[254]

As noted above, in modern claims adjusting, insurers frequently have essentially given independent contractor adjusters and MGAs something quite close to "sole and complete control and management" of the claims process and other aspects of the insurer-policyholder relationship. Applying this general maxim of agency from the *Restatement (Second)* rather than the disclosed principal immunity of *Restatement (Second)* § 320, logically would require that claims intermediaries be held accountable for their negligence to apt third parties without reference to whether the third party enjoys a contractual relationship with the intermediary. Other sections of the *Restatement (Second)* all are quite supportive of agent liability under apt circumstances.[255]

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[253] *See* REUSCHLEIN & GREGORY, *supra* note 249, § 128 at 203 (citing ALI RESTATEMENT (SECOND) OF AGENCY §348A). The citation to § 348A seems a bit off here in that this section specifically addresses "Trespass to Land" rather than general negligence. However, other portions of the *Restatement (Second)*, particularly § 343, support this view. *See* RESTATEMENT (SECOND) OF AGENCY §348-§348A.

[254] *See* REUSCHLEIN & GREGORY, *supra* note 179, § 128, at 203 (citing Paul v. Sharpe, 181 Ga. App. 443, 352 S.E.2d 626, 629 (1987) and Robinson v. Allstate Ins. Co., 399 So. 2d 288, 290 (Ala. 1981)).

[255] *See, e.g.*, RESTATEMENT (SECOND) AGENCY § 343 (1958):

> An agent who does an act otherwise a tort is not relieved from liability by the fact that he acted at the command of the principal or on account of the principal, except where he is exercising a privilege of the principal, or a privilege held by him for the protection of the principal's interests, or where the principal owes no duty or less than the normal duty of care to the person harmed.

Restatement (Second) Agency § 350 (1958):

An agent is subject to liability if, by his acts, he creates an unreasonable risk of harm to the interests of others protected against negligent invasion.

Restatement (Second) Agency § 344 (1958):

An agent is subject to liability, as he would be for his own personal conduct, for the consequences of another's conduct which results from his directions if, with knowledge of the circumstances, he intends the conduct, or its consequences, except where the agent or the one acting has a privilege or immunity not available to the other.

Restatement (Second) Agency § 347 (1958):

(1) An agent does not have the immunities of his principal although acting at the direction of the principal.

(2) Where, because of his relation to a third person, a master owes no duty, or a diminished duty, of care, a servant in the performance of his master's work owes no greater duty, unless there has been reliance by the master or by a third person upon a greater undertaking by the servant.

Restatement (Second) Agency § 348 (1958):

An agent who fraudulently makes representations, uses duress, or knowingly assists in the commission of tortuous fraud or duress by his principal or by others is subject to liability in tort to the injured person although the fraud or duress occurs in a transaction on behalf of the principal.

Restatement (Second) Agency § 348A (1958):

An agent who enters the land of another is not relieved from liability for trespass by the fact that he acted on account of the principal and reasonably believed that the principal had possession or the right to possession of the land, or the right to authorize the agent to enter.

Restatement (Second) Agency § 349 (1958):

An agent who does acts which would otherwise constitute trespass to or conversion of a chattel is not relieved from liability by the fact that he acts on account of his principal and reasonably, although mistakenly, believes that the principal is entitled to possession of the chattels.

Restatement (Second) Agency § 351 (1958):

The *Restatement (Third)* continues in this vein, providing a general rule that

> [a]n agent is subject to liability to a third party harmed by the agent's tortuous conduct. Unless an applicable statute provides otherwise, an actor remains subject to liability although the actor acts as an agent or an employee, with actual or apparent authority, or within the scope of employment.[256]

Although this leaves for resolution the sometimes difficult question of whether an agent's conduct is "tortious" in that it negligently, recklessly, or intentionally violated a duty,[257] the modern "hornbook rule" of the

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> An agent who directs or permits conduct of another under such circumstances that he should realize that there is an unreasonable risk of physical harm to others or to their belongings is subject to liability for harm resulting from a risk which his direction or permission creates.

[256] *See, e.g.*, RESTATEMENT (THIRD) AGENCY § 7.01 (2006). Reporter's Note (a) to § 7.01 specifically notes that the section "consolidates treatment of points made by" the RESTATEMENT (SECOND) AGENCY "in several sections, including §§ 217, 343, 344, 345, 346, 347, 348, 349, 350, 351, 358 and 360." *Accord,* Oriental Trading Co. v. Firetti, 236 F.3d 938, 945 (8th Cir. 2001) (applying Nebraska law and finding individual corporate officers personally liable for fraud and misrepresentation even though working for corporate entity as principal); Inter-Connect, Inc. v. Gross, 644 So. 2d 867, 869 (Ala. 1994) (holding the president of the company individually liable for wrongful actions taken in individual capacity); T.V. Spano Bldg. Corp. v. Dept. of Natural Res., 628 A.2d 53, 62 (Del. 1993) (finding the corporate officer is not immune from an action seeking personal liability for his role in corporate pollution).

[257] *See* RESTATEMENT (THIRD) AGENCY § 7.02 (2006) ("agent is subject to tort liability to a third party harmed by the agent's conduct only when the agent's conduct breaches a duty that the agent woes to the third party"). *See also* RESTATEMENT (THIRD) AGENCY § 7.02 cmt. d at 141 (2006):

> Conduct by an agent that breaches a duty owed by the agent to the principal does not subject the agent to liability to a third party who suffers pure economic loss as a result unless the agent's conduct also breaches a duty owed by the agent to the third party. Most cases hold

Restatement is hardly one of automatic immunity for agent misconduct simply because the agent and the third party have not entered into a contract.

The differing strands of hornbook agency law can be reconciled by appreciating that the disclosed principal immunity accorded agents pursuant to § 320 is purely an immunity from being held liable under contract. Section 320 (and its modern equivalent § 6.01 of the *Third Restatement*) provide only that an agent for a disclosed principal "does not become a party to the contract" because of agent status. By expanding this presumptive contract claim immunity into a general immunity from suit by third parties, courts immunizing claims adjusters have engaged in quite a bit of judicial activism in favor of this class of defendants.

The absence of a contract and contract claim hardly ends the inquiry. Actors such as claims intermediaries can still logically be liable in tort. Traditional rule courts have either tended to ignore this or quickly leap to the conclusion that the nature of the claims management process does not create a tort duty of reasonable care toward the policyholder or liability claimant.[258]

This view is wrongheaded for reasons already discussed. The adjuster plays the role of an insurer. Insurers owe a fiduciary duty to policyholders defending liability claims and a near-fiduciary duty to first-party policyholders as well as having more limited duties to third party claimants. By analogy, the claims intermediary ceded substantial authority by the insurer logically owes similar duties.[259]

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that an agent does not owe a duty to a third party when the agent's negligent conduct causes only pure economic loss to a third party.

[258] *See* cases cited *supra* note 21; *see also* cases cited *supra* notes 101-121. *See, e.g.,* Badners v. Prudential Life Ins. Co., 567 So.2d 1242, 1244 (Ala. 1999); Gorab v. Equity Gen. Agents, Inc., 661 P.2d 1196, 1198 (Colo. App. 1983), *overruled by* Cary v. United of Omaha Life Ins. Co., 68 P.3d 462 (Colo. 2003).

[259] At this point in the development of insurance law, insurers no longer contest that they owe duties of good faith to policyholders; however, they often argue against having a full-fledged fiduciary duty, even in liability insurance cases. Although most insurers and counsel are likely to also argue that claims intermediaries are mere agents and do not stand in the insurers' shoes as alter egos, at least one commentator appears to accept the proposition that where an intermediary is sufficiently like an insurer or performing functions of an insurer, liability should attach. *See Federal Court Predicts Rhode Island Supreme Court*

Even without putting the intermediary in the shoes of the insurer, the very nature of the relationship is one creating a duty of reasonable care and basic honesty and competence. The intermediary is aware of the policyholder or third party's dependency upon the adjuster and it is reasonable foreseeable that intermediary negligence or other misconduct could cause significant injury.

Under these typical circumstances of claims intermediary activity occurring every day in the field, the standard test for imposing tort liability is clearly met. Section 320's general prohibition on imposing a contract relationship where the agent represents a disclosed principal hardly negates this basis tort analysis.

Properly understood, then, traditional agency law does not foreclose liability for claims intermediaries and certainly does not grant them broad immunity for their negligence or greater misconduct toward policyholders and third parties.

In addition, adverting again to contract law for a moment, the traditional contract claim immunity and lack of privity defense made by intermediaries arguably conflicts with the modern view of the rights of third party beneficiaries. Historically, contract law was reluctant to recognize a claim for breach by one who was not a party to the contract breached. However, even in the 19th Century, third parties might have rights under a contract if they were sufficiently within the contemplation of the contracting parties or at least intended to benefit from the contract. By the 21st Century, this historical view has expanded somewhat, with courts more often characterizing a contract claimant as an "intended" beneficiary with rights rather than an "incidental" beneficiary with no rights.[260]

Will Permit Policyholder to Sue Independent Claims Administrators for Common Law Bad Faith in Limited Circumstances, INS. LITIG. REP., Feb. 15, 2007, at 149-150 (supporting general rule in cases of mere intermediary agency but conceding that "[a]rguably, principles of joint venture provide a more theoretically sound basis for imposing liability on a claims adjuster who shares economic risk with the insurer and has significant control over the claims-handling process" and citing the "joint venture" liability cases of *Wohlers v. Bartgis* and *Farr v. Transamerica Occidental Life Ins. Co.*, *supra* notes 92-97). My proposed liability for claims intermediaries is only a modest extension of this concept in that it dispenses with the requirement that there be an economic risk partnership between insurer and adjuster. Under my view, it should be sufficient if the intermediary has significant control over the claims process.

[260] *See* EPSTEIN, MARKELL & PONOROFF, *supra* note 126, at 917-18; FARNSWORTH, *supra* note 10, §§ 10.2- 10.3; *see generally* Anthony Jon Waters,

The insurance intermediary situation is one in which it clearly appears that both insurer and TPA or adjuster are aware of the position and rights of a policyholder or claimant and where the insurer's contractual retention of an independent contractor to process a claim is intended to benefit the third party. If not, the insurer hiring the intermediary would appear to be in at least technical bad faith in that it has failed to give the policyholder's interests (in getting a fair and swift adjustment of the claim) as much consideration as it has given its own interests (in processing the claim in a swift manner the minimized payouts by the insurer).

B. PRACTICAL CONSIDERATIONS: THE BENEFITS OF POTENTIAL LIABILITY FOR CLAIMS INTERMEDIARIES

Because lack of contract privity and agency law do not compel immunity for claims intermediaries, the question of intermediary liability is best answered through a functional analysis of the relative net benefits of permitting suits against such intermediaries. In contrast to majority rule courts such as *Sanchez v. Lindsey Morden Claims Services, Inc.*,[261] my application of instrumental, public policy concerns leads to a view that immunity for claims intermediaries is clearly unwise and that at least in some instances, these intermediaries should be subject to liability.

As outlined above in discussing *Sanchez* and similar cases, the public policy arguments mustered in defense of the traditional rule are weak. The claim that insurance intermediaries should be immune from tort liability because they lack the protection of contractually set limits on liability[262] is particularly bizarre. By this reasoning, one might just as well conclude that there should be no tort liability for negligent driving since the unfortunate auto accident defendant never had the opportunity to negotiate with his victim about perhaps agreeing to a lower limit on liability.

The Property in the Promise: A Study of the Third Party Beneficiary Rule, 98 HARV. L. REV. 1109 (1985).

[261] 84 Cal. Rptr. 2d 799 (1999), *see supra* notes 122-149 and accompanying text.

[262] *See supra* notes 49-141 and accompanying text (discussing this rationale, as most prominently advanced in *Sanchez* and *Hamill v. Pawtucket Mut. Ins. Co.*, 892 A.2d 226 (Vt. 2005)). *See also* Meineke v. GAB Bus. Servs., Inc., 991 P.2d 267, 270 (Ariz. Ct. App. 1999); King v. Nat'l Sec. Fire & Cas. Co. 656 So. 2d 1338, 1339 (Fla. Ct. App. 1995).

Similarly, if one accepts this rationale for tort immunity, one might even prohibit a tort claim against a mugger, unless perhaps the mugger had an adequate opportunity to negotiate a contractual limit on his liability for assault and battery.

This simple illustration not only underscores the common sense absurdity of this attempted justification for claims adjuster immunity but also raise a question of legal doctrine. What on earth is the consideration that would support a bargain in which a victim agrees to limit its right of recovery against (in ascending order of blameworthiness) an errant driver, a sloppy adjuster, or a mugger? None comes readily to mind, suggesting that this attempt to turn lack of contract privity into not only a shield but a sword fails as anything but alchemy via ipse dixit.

As discussed above, the notion that an insurer limits its tort liability by contract is itself incorrect. The policy limits of an insurance policy are a contract-based limitation on a particular type of contract damages, but they hardly constitute the cap of an insurer's potential liability. As a matter of contract, most liability policies provide a "defense outside of limits" to the policyholder, which means that the insurer is responsible for paying reasonable counsel fees and other defense costs until policy limits are exhausted. In a sufficiently involved case implicating a policy with high limits, defense costs can be millions or even tens of millions of dollars for which there is no documented cap. The insurer's good faith duties bar it from hurrying to exhaust policy limits simply as a means of lowering its defense expenditures.[263] Beyond this, an insurer that acts in bad faith is, in most states, also subject to consequential contract damages that are not confined to the policy limits as well as being subject to tort damages, including noneconomic damages such as intentional infliction of emotional distress and the possibility of punitive damages.

Similarly, the defense of the historical rule premised on a need to tamp down the costs of claims adjustment and insurance premiums is similarly flawed, both as to fact and public policy. We simply do not know whether forcing adjusters to internalize at least some of the external costs of their errors would inevitably lead to price increases. Economic theory may predict this but countervailing theory predicts that the effect would be minimal or even overshadowed altogether by market conditions and the degree of competition for claims intermediary work or insurance sales.

A strong case can be made that imposing liability for misconduct is not likely to have a great impact on insurance prices unless misconduct is

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[263] *See* STEMPEL, *supra* note 27, at § 10.03.

rampant. If not, there will only be a few cases even brought, with fewer cases still resulting in judgments against intermediaries. After judgment, the amount may or may not be enough to prompt a recouping price increase. In some instances, the intermediary may not be able to increase prices and will simply need to absorb the loss and lower profits. In the absence of compelling proof that making claims intermediaries subject to the tort system would bring substantial economic net costs, the judicial system would be wise to stick to doctrine rather than implicitly legislating immunity on speculative grounds. Applying traditional doctrinal analysis, a claims intermediary seems at least as likely a candidate for a negligence action as does an errant driver, restaurant owner, or shopping center.

In addition, the "prices will rise" rationale for limiting intermediary liability, whatever empirical truth it might have, lacks persuasive force as a public policy proposition. It assumes without discussion that an aggregate increase in adjusting costs or insurance costs is bad. That hardly follows. Rather, the question is whether an increase in adjusting costs is outweighed by the benefits of forcing adjusters to act with greater care, providing an alternative source of recovery for victims of bad adjusting, and the moral accomplishment of holding business and social actors responsible for wrongful conduct.

Depending on the amount and magnitude of intermediary misconduct, resulting liability, and aggregate price increases, reasonable minds might differ over the cost-benefit analysis. But the majority rule cases barely acknowledge this tension and fail to grapple with it. A better approach would be to resolve doubts in favor of traditional tort law principles – which argue strongly for permitting actions against errant adjusters – and leave any construction of liability based on policy concerns to legislative actors.

Commercial entities such as MGAs and independent adjusters generally have significantly more clout with state legislatures than do policyholders or consumers in general. If there is a good cost-benefit case to be made against intermediary liability, it will be persuasively made by the intermediaries and their political allies. Until that happens, the judiciary would be more consistent with overarching principles of law (primarily agency and tort law) by permitting liability rather than granting immunity to entities that are well-equipped to seek it in the political process.

Particularly in the context of insurance, a field in which both judicial common law and executive/legislative regulation has identified a need to protect vulnerable consumers, it seems most odd to deny to consumers even the possibility of seeking recompense if they are injured by the wrongful activities of a claims intermediary. Many majority rule states precluding actions against claims intermediaries justify this on the ground that the plaintiff third party or policyholder can obtain satisfaction from the insurer-principal of the offending intermediary.[264] However, as well put by the American Law Institute:

> It is consistent with encouraging responsible conduct by individuals to impose individual liability on an agent for the agent's torts although the agent's conduct may also subject the principal to liability. Moreover, an individual agent, when liable to a third party, may be available as a source of recovery when the principal on whose behalf the agent acted is not.[265]

The goals of accountability, fairness, and increase potential for full compensation are served if the claims intermediary is subject to claims in apt situations. Further, it appears to be the case that in operation, the intermediary is effectively the insurer. It is discordant for the law to impose substantial obligations and potential liability on insurers as principals but then to simultaneously prohibit actions against their agents, agents who often have independent, almost unsupervised authority over the claims process.[266]

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[264] *See* Hamill v. Pawtucket Mut. Ins. Co., 892 A.2d 226, 230-31 ("[I]n most cases, imposing tort liability on independent adjusters would create a redundancy unjustified by the inevitable costs that eventually would be passed on to insureds"); *see also* Meineke v. GAB Bus. Servs., Inc., 991 P.2d 267, 271 (Ariz. Ct. App. 1999)("If the adjuster mishandles the claim, the insurer has the same liability to the insured as if an employee of the insurer had mishandled the claim.").

[265] *See* RESTATEMENT (THIRD) AGENCY § 7.01 cmt. b (2006).

[266] Some of the majority rule states shrink from imposing intermediary liability on the ground that the applicable state law "only allows an insured to sue an insurer for bad faith and not simple negligence." King v. Nat'l Sec. Fire & Cas. Co., 656 So. 2d 1338, 1339 (Fla. Ct. App. 1995). In my view, this misunderstands the distinction between bad faith and "mere" negligence. Insurers do not act in bad faith simply because they make mistakes. However, where an insurer intentionally adopts a coverage position that is both mistaken and objectively unreasonable, bad faith takes place. This type of bad faith is essentially a type of negligence that differs from ordinary negligence not because it is done with evil intent per se but

In addition, the relative immunity of claims agents seems incongruous when contrasted to the relatively large exposure to third party claims faced by sales agents, brokers, attorneys, accountants and attorneys. The rationale for the majority rule for claims intermediaries – that adjusters as agents have duties to the principal that are too inherently in conflict with any purported duty to third parities[267] – has not prevented actions against other entities with substantial duties of loyalty toward a principal.

In these other professional or semi-professional relationships, there often is no formal written contract between the third party and the intermediary (as is the case with the insurance policy, insurer, and policyholder) but courts have recognized a duty to the claimant because of the nature of the activities of the agent-defendants. The sales agent has an implied contract to provide services and has tort-based duties not to mislead or disserve the applicant or policyholder. The broker often has not only contract obligations but also obligations implied by statute or common law. Accountants as agents do work for their principals that they know will be relied upon by others and for that reason are usually held liable if their negligence misleads those relying on their work. Other actors without contracts may be responsible to others as a matter of tort law.[268]

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because the negligence (in the form of unreasonable policy interpretation or conduct) takes place over an extended period of time. It is not like the split-second of driving negligence that can create tort liability but it is a type of negligence nonetheless, even though the legal system has given it the much more sinister-sounding name of bad faith.

[267] *See, e.g.*, *Meineke*, 991 P.2d at 270 (Ariz. Ct. App. 1999); *King*, 656 So. 2d at 1339 (Fla. Ct. App. 1995); Velastequi v. Exch. Ins. Co., 505 N.Y.S.2d 779, 780 (N.Y. Civ. Ct. 1986).

[268] *See* Glanzer v. Shepard, 135 N.E. 275, 276-77 (N.Y. 1922). In this case, Judge Cardozo and the New York Court of Appeals found that a merchant could be liable for injury caused by inaccurate weighing of goods sold. Later, in Ultramares Corp. v. Touche, 174 N.E. 441, 449-50 (N.Y. 1931), Cardozo and the court were unwilling to extend the same analysis to public accountant auditors, a result that has been significantly criticized and ultimately was rejected by the RESTATEMENT (SECOND) OF TORTS § 552 (1977). *See also* Moch Co. v. Rensselaer Water Co., 247 N.Y. 160, 168 (N.Y. 1928) (finding no liability for service interruption that adversely affected the general public but not persons who were intended third party beneficiaries of a contract). Cardozo became fonder of constricted tort liability as he aged. *See* Palsgraf v. Long Island R.R., 162 N.E. 99 (N.Y. 1928), another result that has netted criticism and not been universally followed in other states. *See*

In nearly all states, a policyholder victimized by poor attorney defense of a claim subject to liability insurance has a right to sue for damages even though there may not be a formal written contract between these entities and the policyholder. Rather, a contract is implied in many of these relationships, particularly the attorney-client relationship that results from liability insurer defense of a third party's claim against the policyholder. In many states, the insurer may sue the attorney for malpractice even though the primary attorney-client relationship is between lawyer and policyholder (although there is clearly a contract between insurer and defense attorney).[269] Even where counsel is adverse and where sensitive information is acquired through the representation of a client, an attorney is sometimes permitted to disclose it (over the client's objection) to the opponent[270] and may arguably have an obligation to do so.

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generally JOHN T. NOONAN, SR., *The Passengers of* Palsgraf *in* PERSONS AND MASKS OF THE LAW (1976).

[269] *See generally* STEMPEL, *supra* note 27, at § 9.03[A]. *See, e.g.*, Paradigm Ins. v. Langerman Law Offices, 24 P.3d. 593, 601-02 (Ariz. 2001) (finding that an insurer may bring a malpractice suit against an attorney it retained to represent a policyholder in an underlying tort litigation even though the attorney's primary client is the policyholder); State Farm Mut. Auto. Ins. Co. v. Traver, 980 S.W.2d 625, 628-29 (Tex. 1998) (holding that a policyholder may not hold an insurer vicariously liable for an attorney's alleged malpractice because the attorney represented the policyholder and was obligated to exercise independent professional judgment rather than robotically follow insurer's direction).

[270] *See* Spaulding v. Zimmerman, 116 N.W.2d 704 (Minn. 1962) (attorney who learns through adverse medical exam that plaintiff suing attorney's client has brain aneurysm not prohibited by lawyer confidentiality rules from disclosing condition to plaintiff so that plaintiff may get necessary medical attention). Presumably, the examining physician would also be permitted to make this disclosure.

I would even argue that both the lawyer and the doctor were required to make the disclosures in order to protect the health and life of the plaintiff. Even though the plaintiff was not a client or patient, the circumstances gave rise to a duty to at least tell plaintiff if they learned anything important about his medical condition that was relevant to future treatment.

Whether the doctor or an insurer retaining the doctors can be held responsible for failing to detect an aneurysm like that in *Spaulding v. Zimmerman* is a different and more difficult question. *See, e.g.*, Basil v. Wolf, 935 A.2d 1154 (N.J. 2007). The court held that Ms. Basil, widow of a decedent worker examined by a doctor

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for an independent medical examination as part of workers compensation claim adjustment, did not have claim against the insurer for the doctor's failure to make timely diagnosis of decedent's spindle cell tumor that eventually became Stage IV Sarcoma that killed decedent some 30 months later. *Id.* at 1172. Neither did Ms. Basil have a negligence claim against Dr. Wolf as medical intermediary working for the insurer. *Id.* at 1176. The court viewed the doctor was retained by insurer only for limited evaluative purposes and that the insurer was not providing medical treatment to Mr. Basil. *Id.* at 1172. A separate medical malpractice claim against Dr. Wolf individually was settled.

Basil v. Wolf is a problematic opinion. On one hand, Dr. Wolf was not exactly Dr. House (the brilliant but irascible character in the television series of the same name). Dr. Wolf initially diagnosed Mr. Basil as having a "probable hematoma" that should be treated by physical therapy. Basil sought an MRI or x-ray prior to beginning any regime of physical therapy, presumably because he wanted to make sure there was not a more serious problem or something that would counsel against therapy. On the other hand, Dr. Wolf did in a subsequent visit recognize that the condition was getting worse and that an x-ray was the "logical" next step. The x-ray was negative and an MRI recommended. But the x-ray did not take place for months and Dr. Wolf did not authorize an MRI until months after that. Although Dr. Wolf, a retired orthopedic surgeon who had canceled his malpractice coverage upon becoming an evaluator/consultant (which suggests the Ms. Basil did not get a big medical malpractice settlement), can be said to have had only a limited assignment as an agent of the insurer, it is a little hard to square this characterization of his and the insurer's role with what seems to be Dr. Wolf's practical power as a gatekeeper for the insurer and the insurer's practical power over the treatment Ms. Basil received.

The slow pace of diagnosis and treatment, seemingly spurred by Ms. Basil's retention of legal counsel, hardly makes a strong case for immunizing either Dr. Wolf or the insurer. The case was decided on summary judgment, with the New Jersey courts taking the view that there were no material contested facts requiring trial. This is pretty broad immunity to give an insurer or an agent of Dr. Wolf's type as a matter of law in view of their important role in examining the health of a person in connection with a claim of this sort. Even if this was in the context of a contested workers compensation claim, it still seems overly forgiving to excuse the insurer or the doctor as a matter of law and find that Mr. Basil was not really enough of a "patient" to have the protections of medical malpractice law. Although permitting an independent action for malpractice against the doctor may be enough of a correction in most cases, *Basil v. Wolf* appears to provide too little incentive for intermediaries or insurers to take seriously their reasonable obligations to claimants.

Courts have divided as to whether insurers are vicariously liable for the conduct of defense counsel retained and directed by an insurer[271] and have also divided as to whether a third party other than the client or insurer may sue insurer-provided defense counsel. Where attorneys have escaped liability to third parties, this has generally been based upon the rationale that the attorney's duty of fiduciary loyalty and zealous representation on behalf of a client (even a misguided or unreasonable client) makes it inappropriate to dilute this loyalty or create a countervailing loyalty by permitting tort actions against counsel by third parties.[272] Although this may be a reasonable if problematic assessment

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[271] *See* Rose v. St. Paul Fire & Marine Ins. Co., 599 S.E.2d 673, 682-86 (W. Va. Ct. App. 2004) (collecting cases finding vicarious liability and cases rejecting it) (also noting that some states permitting vicarious liability may require actual insurer knowledge of attorney misconduct while others will permit liability through imputed or constructive knowledge of attorney misconduct by insurer). *See also* Horwitz v. Holabird & Root, 816 N.E.2d 272, 287 (Ill. 2004) (noting same split in jurisdictions)

After careful consideration of this conflicting authority, we conclude that when, as here, an attorney acts pursuant to the exercise of independent professional judgment, he or she acts presumptively as an independent contractor whose intentional misconduct may generally not be imputed to the client, subject to factual exceptions. *Id.* at 278.

In reaching its holding, the *Horwitz* Court noted that its view conflicted with the RESTATEMENT (SECOND) OF AGENCY § 253, which provides in Comment a that "[t]he fact that the attorney is subject to discipline by the court does not prevent the client from being liable for his [tortuous] conduct." *See id.* at 280. The Court further noted that it disagreed

> with the Restatement's discounting that attorneys are constrained by certain court-imposed ethical considerations that serve to distance their behavior from their clients. Attorneys cannot blindly follow their clients' directions, even if those directions are particular and express, if doing so would require them to violate their ethical obligations.

See id. at 280.

[272] *See, e.g., Horwitz,* 816 N.E.2d at 277, 284. The *Horwitz* Court itself was divided in that three judges dissented. *See id.* at 284 (McMorrow, J., dissenting, joined by Garman, J.) (finding sufficient agency relationship to support vicarious liability even though attorney was independent contractor); *Id.* at 297 (Freeman, J. dissenting) (favoring application of *Restatement (Second) of Agency* § 253 to situations such as instant case). *Id.*

where attorneys are involved, it is not an apt approach for viewing the relation of insurer and claims intermediaries. The claims intermediary has duties to the insurer as principal but they are not of the same degree and magnitude as those of the attorney to a client.

More important, these divided cases focus on the issue of vicarious liability of the principal for the agent's acts. All states appear to recognize that the attorney can be individually liable for misconduct when representing the policyholder's interests notwithstanding the attorney's fiduciary responsibilities to the insurer as either client or as agent to principal.

Ironically, in at least one state (Washington), a claims adjuster that engages in conduct too tinged with legal analysis and activity (e.g., document drafting) may be liable for de facto malpractice and unauthorized practice of law[273] – but if the adjuster is merely negligent, the protections of the traditional lack-of-privity/disclosed principal approach would appear to apply.[274] In other states, claims intermediaries, particularly public adjusters (nonlawyers who represent policyholders in advancing first party property claims against with insurers) are sometimes held to be engaged in unauthorized practice of law.[275]

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[273] *See* Jones v. Allstate Ins. Co., 45 P.3d 1068, 1079 (Wash. 2002). In *Jones*, however, the adjuster found to have engaged in unauthorized legal practice appears to have been an Allstate employee. Presumably, however, the court's analysis would be equally applied to independent contractor adjusters.

In addition, *Jones* introduces an interesting complexity to Washington law. Adjusters practice law if they give legal consultation or prepare legally operative documents such as the release at issue in *Jones*. However, the court (in a 5-4 decision) ruled that insurance companies using adjusters in this way could continue but that they would be liable to third parties interacting with the adjuster-cum-lawyer if the adjusters' activities fell below the standard of care for a lawyer in similar circumstances. The adjuster in question *Jones* was found to have fallen beneath this standard. *Id.* at 1079.

[274] *See* Kim v. O'Sullivan, 137 P.3d 61, 64-5 (Wash. App. Ct. 2006) (policyholder defended by insurer-selected attorney could not assign malpractice claim to third party bringing suit nor could anti-assignment rule be circumvented by third party's prosecution of malpractice claim; insurer-retained attorney could not be sued for bad faith like insurer). *Id.*

[275] *See, e.g.*, Utah State Bar v. Summerhayes & Hayden, 905 P.2d 867, 872 (Utah 1995); Prof'l Adjusters, Inc. v. Tandon, 433 N.E.2d 779, 780 (Ind. 1982).

But unlike actual lawyers, adjusters who avoid this pitfall, particularly adjusters working as insurance company employees rather than independent contractors, are considerably better protected from liability than real lawyers or adjusters drafting releases. Further, real lawyers have very strong fiduciary duties to clients, sometimes multiple clients, and play an inherently more adversarial, judgment-laden role in the dispute resolution system. Logically, attorneys should have more protection from liability to third parties (but not from their client-principals) than do TPAs and independent adjusters. But in majority rule states, they have less. Something is wrong with this picture.

Recognizing the relationship of insurance intermediaries to policyholders as one supporting tort liability for harm inflicted would put intermediary exposure on a par with that of other actors who conduct activities upon which a reasonably discreet and identifiable number of third parties are known to rely and likely to suffer injury if those activities are negligently performed.[276] Similar results could be supported by a

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[276] For example, in the significant, now venerable case *Biakanja v. Irving*, 320 P.2d 16, 19 (Cal. 1958), the court concluded that a notary public could be held liable to an intended beneficiary for negligent attestation of a will. In reaching this result, the court considered several factors in order to determine whether the notary should owe a duty to parties with whom he did not contract: (1) the extent to which the transaction was intended to affect the claimant; (2) the foreseeability of harm to the plaintiff; (3) the degree of certainty that plaintiff suffered injury (from the defendant's errors); (4) the closeness of the connection between defendant's conduct and the injury; (5) the moral blame reasonably attached to defendant's conduct; and (6) public policy considerations regarding incentives for preventing future harm. *Id.* at 19. *See also* Bus to Bus. Mkts, Inc. v. Zurich Specialties London, Ltd., 135 Cal. App. 4th 165, 168, 37 Cal. Rptr. 3d 295, 297 (Cal. Ct. App. 2005) (reaffirming state's use of Biakanja factors for determining actor's liability to third parties).

This is not a bad set of criteria for determining the existence of duty to third parties in the absence of a contract. As discussed above (*see supra* text accompanying notes 198-204), it often results in liability for accountants, attorneys, engineers, and others who conduct activity that they know will impact others in a non-attenuated way or where third parties are expected to rely on the activity of the professional or intermediary.

Applied to claims intermediaries, the *Biakanja* factors would tend to support liability because (1) the entire adjusting transaction is intended to benefit the policyholder at least as much as the insurer (because the insurer has a non-delegable duty to give equal consideration to the policyholder's interests) and also to benefit, at least to a degree, third party claimants and society; (2) harm from reasonably broad approach to the question of intended third party beneficiaries of contract.[277]

C. A WORKABLE STANDARD OF INTERMEDIARY LIABILITY

One valid concern underlying the traditional approach protecting claims intermediaries from liability is the view that it is unfair to hold agents accountable for errors commanded by the principal. For example, the adjuster denying a claim may itself have recommended payment and merely been the bearer of bad news when it informed a policyholder or claimant that coverage was denied by the insurer. In other situations, the adjuster may have had only a limited investigatory role and no evaluative role.

Although these are valid concerns, they do not logically support a blanket rule of intermediary immunity. Rather, these cases suggest that claims agents should not be strictly or vicariously liable for insurer misconduct or error. Intermediaries should be liable not merely because of an insurer's bad conduct or decision but should instead be potentially liable

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adjuster negligence is foreseeable; (3) harm is often certain where adjusters act negligently or intentionally deny or recommend denial of a claim without proper basis; (4) the adjuster's conduct and an adverse outcome are often closely linked; (5) many adjuster failures are morally blameworthy, particularly in light of their status as agents for a principal that owes a fiduciary-like duty of good faith; and (6) public policy favors holding negligent adjuster accountable in order to discourage errors and their attendant harm.

[277] The historical rule is that a "third party should not be permitted to enforce covenants made not for his benefit, but rather for others [because the third party] is not a contracting party [and] his right to performance is predicated on the contracting parties' intent to benefit him." *See* Jones v. Aetna Cas. & Sur. Co., 33 Cal. Rptr. 2d 291, 295 (Cal. Ct. App. 1994) (citations omitted). Although this may logically prohibit a policyholder landlord's tenant from claiming benefits under the landlord's property insurance policy, the rule should not bar a policyholder from being able to obtain compensation when injured by the actions of a claims adjuster that was retained by the insurer to vindicate the interests of the policyholder under the insurer's policy. Unlike many third parties, the policyholder clearly was intended to benefit from an important contract with the principal and retains rights under that contract even if the principal has outsourced the claims function to an intermediary.

only where a plaintiff has alleged negligence or some greater quantum of wrongdoing by the intermediary.

Already, the majority rule has been relaxed enough that most states permit actions against claims intermediaries where the intermediary and the insurer can be said to have operated as something like a joint venture, particularly where there is some sharing of financial risk.[278] Several other jurisdictions have moved toward permitting intermediary liability under what might be termed a management theory, permitting claims where the intermediary conducts the basic administrative functions of an insurer and has discretion to determine claims outcomes even if the intermediary and the insurer lack sufficient financial links to be deemed a joint venture.[279]

From these already reasonably well established extensions of liability in derogation of the historical rule, it is only a relatively small step toward simply making intermediaries liable under basic tort principles of duty and negligent breach causing damages. Although only a few states (perhaps only Alaska and New Hampshire) support this approach,[280] it is the most sensible means of consistently holding intermediaries accountable and creating adequate incentives for intermediary care.

This proposed approach would not create undue burden on downstream intermediaries or dramatically expand litigation and business transaction costs. The likely additional cost of a negligence regime for policing the actions of claims intermediaries will probably be modest in relation to the gains of greater intermediary care resulting in fewer problems and greater settlement of claims.

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[278] *See supra* text and accompanying notes 77, 87-92.

[279] *See supra* text and accompanying notes 78-82, 81-93. Although it is not often invoked, this principle is sufficiently established that it has in the past appeared to me that this was in fact the general rule: adjusters sufficiently acting as the "functional equivalent" of the insurer may be liable to at least insureds and policyholders and perhaps to claimants under certain situations. *See Stempel on Insurance Contracts*, *supra* note 27 at § 10.02[A] p. 10-17. Further examination of the issue in this article suggests I might have been overbroad in that statement because of the tendency of some courts not to recognize an exception to the privity and disclosed agency defenses even where the administrator or adjuster has assumed the functions of the insurer. In general, however, it appears most jurisdictions will permit liability upon a sufficient showing of adjuster activity as an insurer, particularly if there is financial intertwinement or risk sharing.

[280] *See supra* text and accompanying notes 75-82.

Consistent with the general rule of § 7.01 of the current *Restatement* and its predecessors, an intermediary cannot avoid liability if its conduct is tortuous simply because the conduct was committed in the service of the insurer. However, where an intermediary can demonstrate that it had no discretion in its conduct and that the conduct was completely controlled by the insurer/principal, adherence to the traditional majority rule remains appropriate.

In practical application, this means that many, perhaps most, cases will result in claims against intermediaries surviving motions to dismiss as a matter of law. In the modern real world of insurance law, insurers delegate substantial authority to claims intermediaries as independent contractors. Typically, the intermediary has control over the quality and quantity of investigation conducted, evaluation of the claim, and communication with claimants and policyholders. If the intermediary does not conduct these activities in an objectively reasonable manner (as would a hypothetically reasonable adjuster in that situation), a claim for negligence should lie. But it hardly follows that adjusters who act reasonably will be routinely sued. If they are, they can counterattack via Rule 11 motions or similar measures designed to discourage frivolous claims.[281] At a minimum, adjusters acting reasonably, although perhaps forced to defend more cases because of relatively liberal notice pleading and Rule 12 motion practice standards,[282] are unlikely to ever be wrongfully held liable.[283]

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[281] *See* Fed. R. Civ. P. 11 (imposing sanctions on litigants and counsel under apt circumstances if claim is not factually supported or legally cognizable); 28 U.S.C. § 1927 (permitting imposition of sanctions against litigants or counsel that unnecessarily prosecute unfounded claims). *See also* ROGER S. HAYDOCK, DAVID F. HERR & JEFFREY W. STEMPEL, FUNDAMENTALS OF PRETRIAL LITIGATION §§ 3.5, 11.5 (7th ed. 2008).

[282] Although pleading and motion to dismiss practice is still relatively pro-plaintiff, recent developments have shown that courts are perfectly capable of dismissing claims that are inadequately pleaded or present a far-fetched legal theory of relief. *See* HAYDOCK, HERR & STEMPEL, *supra* note 211, §§ 3.3, 4.1-4.4. Arguably, the modern ethos, at least in federal court, is too nitpicking in its desire to see the complaint plead sufficient facts to support a reasonable chance of litigation success. *See, e.g.*, Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007) (dismissing complaint in antitrust action over dissent of Justices Stevens and Ginsburg).

Naturally, if the intermediary has engaged in misrepresentation, dishonestly, deceit, gross negligence, recklessness, or sharp practices, a liability claim logically should be permitted. If the intermediary has intentionally engaged in unreasonable conduct that deprives a policyholder

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There has also been substantial academic criticism of *Twombly*. *See, e.g.*, Kevin M. Clermont & Theodore Eisenberg, *CAFA Judicata: A Tale of Waste and Politics*, 156 U. PA. L. REV. 1553, 1561, 1592 (*Twombly* "imposed a plausibility test on pleadings, thereby discombobulating a basic area of law and managing to generate 2200 citations in its first five months."); A. Benjamin Spencer, *Plausibility Pleading*, 49 B.C. L. REV. 431 (2008); Suja A. Thomas, *Why the Motion to Dismiss is Now Unconstitutional*, 92 MINN. L. REV. 1851 (2008). *But see* Keith N. Hylton, *When Should a Case Be Dismissed? The Economics of Pleading and Summary Judgment Standards*, 16 S. CT. ECON. REV. 39 (2008) (defending link between heightened review of disfavored antitrust claims at summary judgment stage and seeing *Twombly* as logically extending approach to pleading stage of litigation); Richard A. Epstein, Bell Atlantic v. Twombly: *How Motions to Dismiss Become (Disguised) Summary Judgments*, 25 WASH. U. J.L. & POL'Y 61 (2007) (similar view approving *Twombly* as reflecting heightened scrutiny given antitrust claims in summary judgment motion practice). Irrespective of whether criticism of *Twombly* is well-taken, is seems incorrect to say that motions to dismiss for failure to state a claim are toothless, particularly if the plaintiff is pursuing a relatively recently accepted cause of action such as a claim of insurance intermediary negligence. In addition, where the allegations of intermediary error are particularly weak, the case should logically be amendable to reasonably inexpensive disposition via summary judgment. *See* HAYDOCK, HERR & STEMPEL, *supra* note 211, § 12.3.

[283] Because claims by third parties against claims intermediaries have historically not been permitted, even those jurisdictions that have relaxed or overturned the general rule have rendered decisions very protective of intermediaries in light of the facts of the disputes. *See supra* text and accompanying note 79 and *see infra text and accompanying notes* 221-223 (discussing Oklahoma's *Wathor* case and Mississippi's *Jeffcoat* case). It is only logical that courts will at least subconsciously expect to see relatively substantial error or wrongdoing before holding a previously immune entity to account during the early decades of recognition of a "new" tort of intermediary negligence. At a minimum, adjusters are unlikely to lose weak cases both at trial and on appeal. For example, in *Jeffcoat*, the claimant was stripped of a jury verdict even thought he adjuster's conduct was horrendous. *See infra* text and accompanying notes 221-223. There is simply no good reason to expect that allowing tort claims against administrators and adjusters will produce an avalanche of judgments against these intermediaries.

of the benefit of the insurance bargain or that fails to give equal consideration to the interests of the policyholder, the adjuster should be subject to a bad faith claim.

In response to such claims, claims intermediaries should be required to defend on the merits if they are to avoid liability. One available defense for the intermediary – at least as respects only the decision to deny a claim -- would be that it acted solely upon the instruction of the principal and had no discretion to disobey. Although this is more forgiving standard than that applicable to most agents in tort cases, it would respond adequately to whatever core kernel of value might remain in the traditional approach. However, even if the adjuster was merely a conduit for the insurer's decision on coverage or payment, the adjuster should be subject to liability where it has been negligent (or worse) in its processing of the claim.

In addition, intermediaries might in some cases successfully defend on the slightly different ground that although the insurer did not exercise iron-fisted control or micromanagement of adjuster activity the nature and circumstances of the retention were sufficiently limited that the adjuster's conduct cannot be considered negligent or wrongful in context. This is similar to one majority rule court's sentiment that "[t]he independent adjuster's obligation is measured by the contract between the adjuster and the insurer. The adjuster that contracts to perform a $200 investigation is not obligated to expend the same effort that might be reasonable for a fee of $2000, nor is it obligated to continue when the insurer advises it to stop."[284]

This sensible case-specific view would prevent small, relatively blameless adjusters (who logically would have done little significant harm) from being saddled with potentially company-closing liability. Such a context-based defense is a permissible means of softening the edges of tort liability but does not support blanket immunity for claims intermediaries. Rather, it supports a general rule permitting third party actions against intermediaries under the well-established principles of tort law and adjudicating them with sensitivity to the overall facts of the adjuster's assignment and performance.

Independent contractor adjusters and insurers should not be permitted to institutionalize negligent or bad faith performance by knowingly or routinely contracting for adjuster activity and compensation

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[284] *See Meineke*, 991 P.2d at 271.

that is so low as to encourage insufficient care in the claims management process. Neither should an adjuster be insulated from liability where it stops investigating under circumstances where this is unreasonable under the circumstances or reflects a failure to give adequate attention to the interests of a policyholder.

Moving to wide recognition that insurance administrators and claims intermediaries can be liable for negligent infliction of injury to policyholders and other reasonably foreseeable claimants would also be a healthy step away from the current caselaw's excessive focus on bad faith liability and recognize that an intermediary may do considerable harm even if not acting as an insurer and that even where bad faith liability is inappropriate, the intermediary should not be completely immune from the consequences of its actions.[285]

In addition, cases in some jurisdictions, although permitting claims against intermediaries under the heightened standards of management theory or joint venture, have exhibited perhaps an undue tendency to shrink from finding sufficient insurer-like conduct by the intermediary, effectively keeping the historical rule of adjuster immunity in place even in cases where the intermediary is doing insurer-like adjusting and should be held accountable for injury inflicted on foreseeable parties, particularly policyholders.[286]

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[285] This has been recognized over the years in cases rejecting bad faith liability for claims intermediaries but noting that other causes of action, such as a simple tort action sounding in negligence, may under apt circumstances be available to those injured by the intermediary. *See, e.g.*, Hudock v. Donegal Mut. Ins. Co., 264 A.2d 668, 672 n. 3 (Pa. 1970) (plaintiffs' "allegations as to the adjusters and their agents might establish a cause of action in tort" but because instant action framed in contract, plaintiffs cannot recover due to lack of privity); Stone v. New Eng. Ins. Co., 39 Cal. Rptr. 2d 714, 731 (Cal. Ct. App. 1995) (inability to maintain claim under insurance contract or unfair claims practices statute may not foreclose other claims sounding in tort or based on other statutes).

[286] For example, in *Wathor v. Mut. Assur. Admin*, 87 P.3d 559 (Okla. 2004), discussed *supra* text and accompanying notes 79, 84-86, the court found – as a matter of law – that the administrator in question had not acted sufficiently like an insurer to permit the insured to bring a claim against the administrator even though the facts as set forth in the case report would appear to permit a reasonable inference that the administrator had been delegated the bulk of the entire claims function by the insurer. *See id.* at 563 ("[administrator] unquestionably performed some of the tasks of an insurance company in its claims handling process").

The problem with requiring a financial pooling of risk as a prerequisite to administer or adjuster liability is that it fails to appreciate the degree to which claims intermediaries have plenty of incentive to mistreat policyholders and other claimants under straight fee-for-service contracts. Like any vendor, an independent contractor claims intermediary wants to please the party that hired it in order to gain continued future employment and to continue to charge adequate prices. Even without formal risk sharing or economic partnership per se, the independent claims intermediary has substantial incentive to resist claims, knowing that this will save the insurer money (at least in the short run) and result in favorable reviews of the adjuster's work (and future business). Although substandard, overly stingy administration and adjusting may result in successful litigation against the insurer, this does not provide sufficient incentive for optimal adjuster care, certainly not adjuster behavior that gives equal consideration to the interests of policyholders.

First, any litigation consequences of adjuster misconduct are likely to come years after the misconduct. By this point, the adjuster will have already attained financial reward from taking a hard line against claims and the relationships between the intermediary and insurer personnel are often sufficiently close that the insurer is unlikely to hold the adjuster accountable and to replace the adjuster. In addition, by this point, insurer and adjuster may be in a "trench warfare mentality" where even after an

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Although the court majority put great stock in the insurer's apparent final say as to claims payment, the dissent correctly noted that the rule of *Restatement (Second) of Agency* § 343 was that an agent committing a tort is not relieved of liability simply because the agent's tortuous action was commanded by the principal or "on account of the principal." *See id.* at 565 (Opala, J. and Watt, J., dissenting).

The majority was unmoved, however, finding liability inappropriate because the administrator did not have its compensation package expressly tied to the approval or denial of claims and "did not share the risk of loss with the [insurer, here an employer's health plan]. As discussed in text, the requirement of financial risk sharing and entrepreneurial partnership as a prerequisite for administrator liability is unnecessarily demanding.

Equally disturbing is that the court never addressed Brown v. State Farm Fire & Cas. Co., 58 P.3d 217 (Okla Ct. App. 2002), which recognized that independent investigators and adjusters could be liable under simple tort and negligence principles based on duty created by their relation to policyholders and the foreseeability that inadequate claims processing could injure the policyholder. *Brown* was not even cited in passing by the *Wathor* Court. *See generally id.*

adverse judgment they continue to fail to see what was done wrong in dealing with the policyholder or claimant.[287]

Second, and perhaps more troubling but more difficult to ascertain is the prospect that the insurer, which profits from delay in claims resolution and the time value of money, silently is happy to have adjusters take an overly hard line. As previously discussed,[288] this permits the insurer to "have it's cake" (funds that do not have to be paid until after an adverse court decision) and "eat it, too" through minimizing its potential bad faith exposure by pointing the finger at the claims intermediary as the actual active agent of misconduct or the purveyor of bad investigation or evaluation that led the insurer astray. In return for continuing to receive business from the insurer, the claims intermediary can, under the current regime, act as the insurer's foil because it is unlikely to be held accountable under the law unless it has sufficiently supplanted the insurer, perhaps even rising to a level of a joint venturer.

For these reasons, subjecting independent adjusters and administrators to the same tort regime that largely governs everyone else and their activity seems both modest and justified. A compromise position of sorts would be like that of Mississippi, which immunizes intermediaries from claims sounding only in negligence but may find liability where there was been gross negligence, recklessness, or some misconduct greater than negligence. Although this would be an improvement over the traditional approach, it still permits too much avoidance of responsibility and too little incentive for claims intermediaries. Cases decided under this heightened standard of requiring "more than negligence' can exhibit an alarming tendency to characterize even outrageous behavior or missteps as only mere negligence.

For example, in *Gallagher Bassett Services, Inc. v. Jeffcoat,*[289] the Mississippi Supreme Court held (albeit over a strong dissent) that there was

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[287] Perhaps most amazingly and notoriously, the insurer and its agents involved in the famous *Campbell v. State Farm* litigation, despite having been held to have acted in bad faith for egregious failure to settle a resolvable claim and protect the policyholder, including a $145 million punitive damages award (eventually reduced to $9 million) continued to maintain for more than 25 years that nothing wrong had been done. *See* STEMPEL, LITIGATION ROAD, *supra* note 27, chs. 10, 14-23 (2008).

[288] *See supra* text and accompanying notes 146-47.

[289] Gallagher Bassett Servs., Inc. v. Jeffcoat, 887 So.2d 777 (Miss. 2004).

as a matter of law nothing worse than negligence in a situation where the adjuster: misrepresented its activities to the claimant; withheld assessing the amount of coverage until receipt of a legal opinion; never requested the legal opinion; was not licensed in Mississippi; was not trained in Mississippi insurance principles, in particular the question of "stacking" of policy coverages that was at the core of the dispute; and failed for months to take any concrete action to acquire necessary knowledge that it did not have (including failing to insist that the insurer provide necessary information).[290] The evidence of gross negligence, reckless, or intentional dereliction of duty by the adjuster was substantial albeit contested (both the adjuster and the plaintiff presented dueling expert witnesses) but this did not stop the *Jeffcoat* majority from overturning a jury verdict in Plaintiff Jeffcoat's favor. So much for the protection provided policyholder's under the "gross negligence" standard of care for claims intermediaries.[291]

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[290] *See id.* at 780-83.

[291] In fairness to the Mississippi Supreme Court, at least the case was a close one, essentially decided as a 4-3 opinion (a three-member majority opinion, one concurring justice, and three dissenters). *See id.* at 789. The majority's reluctance to uphold a sizeable verdict against the adjuster may also have been fueled by simple legal realism in that Plaintiff Jeffcoat had already received $1.8 million in compensation from his injuries from the insurer. Just the same, even the majority's description of the adjuster's performance seems to suggest something more than mere negligence. For example:

> Gallagher did not provide training or resources to support its adjusters' work on uninsured motorist claims. Gallagher failed to give its adjusters any resources or training regarding stacking in Mississippi. Although she was generally familiar with stacking, [Gallagher adjuster Juana] Love did not know that stacking was available in Mississippi or how it works until Jeffcoat's lawyer informed her that it is and explained how it works. Love knew that she needed a legal opinion on this issue, but she failed to request one. It escapes us why Love would wait until the [policyholder's truck] fleet schedule was discovered to request an opinion. Clearly, Love could have obtained a legal opinion on whether and how stacking applies in Mississippi without knowing the number of vehicles in the [policyholder's] fleet.
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> Gallagher's adjustment of this claim evinces a complete breakdown of communication and cooperation between two contractually obligated parties, supervisors and subordinates within Gallagher, as well as between two principals and their agent. Important documents related to this policy were not shared with Gallagher either by accident or willfully. The [insurance] carrier's

V. CONCLUSION

Treating insurance intermediaries as mere agents for disclosed principals without contract obligations to policyholders or claimants once arguably made sense and still arguably makes sense to the limited degree that it this approach prevents the intermediary from becoming liable in contract to insurance policyholders and other third parties or vicariously liable for the misconduct of insurers. Increasingly, however, the historical approach of intermediary immunity has become an anachronism in view of the substantial outsourcing of traditional insurer functions to independent contractor intermediaries. In addition, the traditional contract immunity of these intermediaries should never have been permitted to evolve into a de facto immunity from tort liability in cases where intermediary negligence or other misconduct foreseeably injures policyholders or other third parties within the intermediary's zone of duty.

Many courts have begun to recognize the problem and impose liability upon intermediaries who in effect function as insurers themselves rather than mere agents or that are in joint venture-like financial connection with insurers. However, this continues to leave these important actors of modern insurance under-policed to the detriment of policyholders, consumers, and society. Widespread adoption of the tort law approach advocated in this article would improve the incentive structure of intermediary activity and align it with that of insurers and similarly situated social actors, encouraging more consistently apt claims practices.

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representatives were uncooperative with Gallagher, bringing the resolution of Jeffcoat's claims to a standstill or as Love described it, an "impasse."

See id. at 784-85.

Not surprisingly, a jury of presumably rational persons viewed this situation as something more than mere negligence. The state supreme court's overturning of this reasonable verdict as a matter of law suggests that Mississippi's "more than negligence" standard for imposing liability on adjusters is simply too malleable and likely to result in courts straining to avoid adjuster liability. By contrast, a negligence standard would be less susceptible to judicial manipulation.