

# FC&S LEGAL

## The Insurance Coverage Law Information Center

---

### SUPREME COURT OF NEW JERSEY CONFIRMS "FAIRLY DEBATABLE" STANDARD FOR FIRST PARTY BAD FAITH; ACKNOWLEDGES RELEVANCE OF ACTUAL INVESTIGATION

**Frederic J. Giordano and Robert F. Pawlowski**

March 18, 2015

The Supreme Court of New Jersey recently issued an important pair of decisions for policyholders with bad faith claims against their first-party insurance companies in *Badiali v. New Jersey Manufacturers Insurance Group*[1] and *Wadeer v. New Jersey Manufacturers Insurance Company*. [2] In *Badiali* and *Wadeer*, the court reiterated the narrow "fairly debatable" standard as the threshold for bad faith claims in New Jersey. But, the court also opened the door to modify this standard in the *Badiali* decision by recognizing the relevance of the actual claims handling in a particular case.

#### **"Fairly Debatable" Standard**

New Jersey has long recognized that the covenant of good faith and fair dealing is implied in every contract, and that an insurance company owes a duty of good faith to its policyholders in processing claims.[3] The standard set by the Supreme Court of New Jersey in *Pickett* is known as the "fairly debatable" standard—a policyholder must show that the insurance company had no reasonable basis to deny the claim to prevail on a bad faith claim (*i.e.*, if a claim is "fairly debatable," there can be no bad faith).[4] Under the test, "a claimant who could not have established as a matter of law a right to summary judgment on the substantive claim would not be entitled to assert a [bad faith] claim...."[5]

The fundamental flaw of the "fairly debatable" standard, as some courts have applied it, is that it allows actual bad faith to go unpunished; indeed, an insurance company could act in bad faith, utterly fail to make any investigation in breach of its fiduciary duty, for example, yet still avoid the resulting bad faith claims if it turned out that coverage for the claim happened to be "fairly debatable." *Amicus Curiae* urged the court to consider clarifying the rule to avoid this unintended paradox, suggesting that the actual investigation is relevant to a bad faith determination and that courts should not dismiss bad faith claims without discovery on the issue. The Supreme Court did "recognize [the] suggestion that *Pickett*'s 'fairly debatable' standard should include at least some focus on the [claims handling]," but "express[ed] reservation about the potential discovery complications associated with such an approach and thus [did] not adopt such an approach at *this time*." [6] Ultimately, the court found no need "to alter the salutary test set forth" in *Pickett* based on the facts of the cases before it.

#### **The *Badiali* Decision**

Both cases involved bad faith claims against New Jersey Manufacturers Insurance Group ("NJM") related to uninsured motorist ("UM") claims under automobile insurance policies. In *Badiali*, the policyholder suffered injuries when rear-ended by an uninsured motorist. An arbitrator awarded \$29,148.62 to *Badiali*, which was to be split between NJM and another carrier. A provision in the NJM policy provided that such an arbitration decision is binding "unless the arbitration award exceeds [\$15,000]," in which case, either party may demand a jury trial. *Badiali* claimed that NJM acted in bad faith because its share of the claim was less than \$15,000 and it should have paid the claim. The court found *Badiali*'s claim was fairly debatable because of a prior unreported decision allowing rejection of an arbitration award in nearly identical circumstances; NJM was the carrier in that case, as well. Importantly for policyholders, though, the court did hold that, in the future "any reference in a policy of insurance to the statutory \$15,000 policy limit as the basis for rejecting an arbitration award applies only to the amount that the insurance company is required to pay, not to the total amount of the award." [7]

---

## The Wadeer Decision

In *Wadeer*, the NJM rejected several arbitration awards in favor of its policyholder, two within policy limits, one in excess of the \$100,000 policy limits. At trial, a jury awarded the policyholder over \$250,000, but molded the verdict to policy limits. Previously, the policyholder made a \$95,000 offer of judgment under *Rule 4:58-2*, which provides attorneys' fees to an offering party where the award exceeds 120 percent of the offer. The court refused to uphold the lower court's award of attorneys' fees under this rule because, after molding the verdict, the award was below 120 percent of the offer of judgment. The court also rejected *Wadeer's* bad faith claims on *res judicata* grounds; NJM argued that the entire controversy doctrine barred the claim, as well. In considering the entire controversy doctrine, the court observed that "[a]cts of first-party bad faith in the UM context can, and often will, continue throughout the course of the underlying legal proceedings" and "an insurance carrier's acts of bad faith may often not cease until a verdict is returned, and this is only after the plaintiff has been forced to fully litigate the matter through arbitration and trial." [8] The court, thus, iterated its belief that "viewing bad faith claims as separate and distinct actions promotes judicial efficiency and economy." [9]

The Supreme Court in *Wadeer* recommended that the Civil Practice Committee consider several issues that would inure to the benefit of policyholders, if adopted:

- (1) whether to allow policyholders to first assert party bad faith claims after resolution of an underlying uninsured motorist action under the entire controversy doctrine;
- (2) whether the trigger for the offer of judgment rule in the uninsured/underinsured motorist context should be an actual damages verdict instead a molded verdict entered by the court; and
- (3) whether to expand *Rule 4:42-9(a)(6)*'s allowance for counsel fees "in an action upon a liability of indemnity policy of insurance, in favor of a successful claimant" to first-party insurance claims.

### Conclusion

New Jersey policyholders should keep an eye on the Committee for any changes to these rules that would bolster a policyholder's ability to recover against its insurance company.

---

### Endnotes

[1] ---A.3d---, 2015 WL 668206 (NJ).

[2] ---A.3d---, 2015 WL 668229 (NJ).

[3] See *Pickett v. Lloyd's*, 131 N.J. 457 (1993); *Sensient Colors, Inc. v. Allstate Ins. Co.*, 193 N.J. 373, 393–394 (citing *Pickett*).

[4] *Pickett* 131 N.J. at 473–74.

[5] *Id.*

[6] *Badiali* at \*8 (emphasis added).

[7] *Badiali* at \*11.

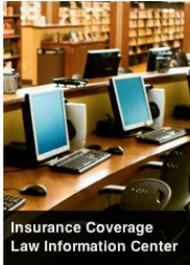
[8] *Wadeer* at \*10.

[9] *Id.*

### About The Authors

**Frederic J. Giordano** is a partner at **K&L Gates LLP**, concentrating his practice on insurance coverage litigation and counseling and complex civil and commercial litigation. He may be contacted at [frederic.giordano@klgates.com](mailto:frederic.giordano@klgates.com).

**Robert F. Pawlowski** is counsel at **K&L Gates LLP**, focusing his practice on insurance recovery, insurance coverage litigation, and complex commercial litigation. He may be contacted at [robert.pawlowski@klgates.com](mailto:robert.pawlowski@klgates.com).



Insurance Coverage Law Information Center



Our Professionals



Insurance Coverage Law Report



Resources & Forms



Eye on the Experts

## For more information, or to begin your free trial:

- Call: 1-800-543-0874
- Email: [customerservice@SummitProNets.com](mailto:customerservice@SummitProNets.com)
- Online: [www.fcandslegal.com](http://www.fcandslegal.com)

**FC&S Legal** guarantees you instant access to the most authoritative and comprehensive insurance coverage law information available today.

This powerful, up-to-the-minute online resource enables you to stay apprised of the latest developments through your desktop, laptop, tablet, or smart phone —whenever and wherever you need it.

**NOTE:** The content posted to this account from **FC&S Legal: The Insurance Coverage Law Information Center** is current to the date of its initial publication. There may have been further developments of the issues discussed since the original publication.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting or other professional service. If legal advice is required, the services of a competent professional person should be sought.