

# A Right Without a Potent Remedy: Indiana's Bad Faith Insurance Doctrine Leaves Injured Third Parties Without Full Redress

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## I. INTRODUCTION

Insurance companies in the United States operate under heavy state regulation,<sup>1</sup> but state regulation of the insurance industry as a whole does not completely protect the average insurance policyholder.<sup>2</sup> The primary vehicle for policyholders to protect

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1. All fifty states have an insurance department designed to regulate the insurance industry. Ralph Nader, *Foreword* to WILLIAM M. SHERNOFF, *HOW TO MAKE INSURANCE COMPANIES PAY YOUR CLAIMS & WHAT TO DO IF THEY DON'T*, at vii (1990). *See generally* KATHLEEN HEALD ETTLINGER ET AL., *STATE INSURANCE REGULATION* 79-103 (1st ed. 1995).

2. *See* WILLIAM M. SHERNOFF, *PAYMENT REFUSED* 14-16 (1986); *see also* Nader, *supra* note 1, at vii-ix. Ralph Nader, in his typical style, describes state regulation of the insurance industry as a “farce.” Nader, *supra* note 1, at vii. Nader explains that a policyholder who has been angered by the bad-faith tactics of her insurer may “seek redress from the state insurance commissioner, but . . . this is rarely effective.” *Id.* at ix. According to Nader, state insurance commissioners fail to protect policyholders because the commissioners are too closely aligned with the insurance companies and their “lobbying muscle” to “concern themselves with the rights of the consumers.” *Id.* at viii.

For a discussion of the inability of Indiana's Department of Insurance to protect Indiana policyholders, see Scott J. Paltrow, *A Matter of Policy: How a State Becomes Popular With Insurers But Not Consumers*, WALL ST. J., Jan. 14, 1998, at A1. The Indiana Department of Insurance:

has a hard time regulating the more than 1,800 insurance companies it licenses. [Its] tiny budget, along with laws limiting the department's enforcement powers and a generally warm relationship between the state Legislature and the insurance industry, have combined to give Indiana one of the least-effective insurance departments in the nation.

. . . .  
. . . [T]his helps explain why insurance companies are flocking to Indiana. In 1994, consulting firm Conning & Co. surveyed insurance companies to find out which of the 50 states they believed provided the most insurer-friendly regulatory environment. Insurers ranked Indiana second, after Illinois, for insurance sold to individuals, and first for commercial insurance.

Since 1994, the number of companies licensed to sell insurance in the state has risen eight percent, to 1,828, while the number of insurers with headquarters in the state has grown nearly thirteen percent, to 206. “Indiana has been a wonderful state for insurance companies to do business in,” says Mr. [Stephen A.] Williams, [an] insurance lobbyist.

*Id.*

themselves from an insurance company that settles its policyholders' claims in bad faith is not through state regulation, but through private regulation (that is, through civil litigation).<sup>3</sup> Therefore, in order to check the conduct of powerful insurance companies, their clients—the policyholders—need litigation rights with real teeth.<sup>4</sup>

The insurance industry has grown so powerful that it has been dubbed “the biggest game in the world.”<sup>5</sup> As the industry expands, insurance companies develop

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3. See ETTLINGER ET AL., *supra* note 1, at 103-04; *see also* Nader, *supra* note 1, at vii-ix; SHERNOFF, *supra* note 2, at 14-16. State insurance departments purposefully do not attempt to handle the claims of every policyholder. ETTLINGER ET AL., *supra* note 1, at 103. When a dispute arises between a policyholder and an insurer, the dispute will likely be resolved through private regulation rather than through state regulation. *Id.* “Private regulation” includes lawsuits, arbitration, and appraisal. *Id.* at 104. Civil litigation, rather than state regulation, holds so much more importance for the needs of the average insurance policyholder that even “[m]any [insurance companies'] claims people consider private regulation to be the primary method to assure that claims activities are monitored and that consumers are treated in good faith.” *Id.* at 103.

4. Enhanced private litigation rights are responsible for some of the improvements that insurance companies have made in their claims practices to date. ANDREW TOBIAS, *THE INVISIBLE BANKERS: EVERYTHING THE INSURANCE INDUSTRY NEVER WANTED YOU TO KNOW* 121 (1982). The insurance industry, however, is similar to a self-contained ecosystem: one element cannot change without affecting other elements in the system. Therefore, when one policyholder wins a large damage award through litigation, the price of insurance will increase for all policyholders (as insurance companies charge higher premiums to cover their legal losses). *See* SPENCER L. KIMBALL, *INSURANCE LAW* 4 (1992); *see also* PAT MAGARICK, *EXCESS LIABILITY: THE LAW OF EXTRA-CONTRACTUAL LIABILITY OF INSURERS* § 19.01, at 19-5 (3d ed. 1998); TOBIAS, *supra*, at 121.

It is clear that enhanced private litigation rights “will either lead to improved claims-handling practices . . . , or else to higher insurance rates” for all consumers, “or (most likely) to some combination of both.” TOBIAS, *supra*, at 121. Opponents of enhanced rights for higher private litigants often argue that punitive damages lawsuits against insurers actually harm, rather than help, the average consumer. *Id.* However,

[e]ven some insurance men disagree with that view. “There’s no doubt that the fact that some large punitive damages have been awarded has caused men in my profession to be doubly sure that we’re right,” [The] Travelers [Corporation] senior vice president Ray Stahl told the *Los Angeles Times*. “When these cases [with high jury verdicts] started, we reviewed how we do things, how claims are to be investigated, what action to take for a doubtful case, how to decline a claim. If you proceed professionally there should be no grounds for a suit.” Nor does he think this need be more expensive. “If you do things right the first time round,” he says, “it saves time and energy.”

*Id.* (alterations added).

5. TOBIAS, *supra* note 4, at 11. Tobias’s groundbreaking book on the underestimated importance of the insurance industry describes the vast wealth held by insurance companies. *See id.* at 11-25. Tobias pointed out that, as of 1982, the insurance industry employed many more people than the United States Postal Service or the Internal Revenue Service, *id.* at 11-12, the assets of the United States’s insurance companies “were greater than the combined

different strategies to acquire a niche in the insurance marketplace.<sup>6</sup> Some insurance companies stress agreeable relations with their policyholders.<sup>7</sup> These companies pay a large percentage of their policyholders' claims without unreasonable dispute in hopes of profiting from their company's reputation for customer satisfaction.<sup>8</sup> Other companies try to make money by routinely refusing to honor their policyholders' claims in hopes of cutting costs and improving overall profits.<sup>9</sup> These companies refuse claims in hopes that their policyholders will not or cannot pursue litigation; and, if litigation occurs, these companies believe that the money they save by denying large numbers of claims will exceed any money they lose to litigation costs.<sup>10</sup>

The conduct of the latter type of insurer is precisely why courts began to

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worldwide assets of the nation's fifty largest industrial corporations," *id.* at 14, only banks held a greater share of wealth in America than insurance companies, *id.*, the insurance industry employed more people than the banking industry, *id.* at 16, and, for every dollar that Americans paid in auto insurance premiums, only sixty-five to seventy cents were returned in the form of paid claims, *id.* at 15. Although the statistics in the book are now dated, the book provided a first look at the enormity of the insurance industry.

6. For an interesting juxtaposition of the differing philosophies that insurers may practice in their dealings with claimants, see WILLIS PARK ROKES, *AGGRESSIVE GOOD FAITH AND SUCCESSFUL CLAIMS HANDLING* 6-8 (1987).

Rokes also suggests that extremely adversarial claims handling is a thing of the past, and that this practice has no place in today's insurance climate. *Id.* at 8. One should compare Rokes's statements to the stories of atrocious insurance behavior that come out of courts across the nation. See SHERNOFF, *supra* note 2, at 17; see also TOBIAS, *supra* note 4, at 112-24.

7. For a discussion of the claims-handling characteristics that a company should strive to meet in order to earn the title of "good faith insurer," see ROKES, *supra* note 6, at 107-30.

8. See TOBIAS, *supra* note 4, at 115, 120. See generally Rokes, *supra* note 6, at 107-30.

9. See SHERNOFF, *supra* note 2, at 14, 17; see also Nader, *supra* note 1, at xi; Paltrow, *supra* note 2, at A1 ("Consumer groups and some state regulators cite growing numbers of complaints that insurance companies are arbitrarily refusing to pay some homeowners and automobile claims, or are systematically 'low-balling' customers, offering to pay much less than the full cost of repairs. There are also complaints of a trend, confirmed by some companies, of canceling or refusing to renew coverage of customers who have filed even minor claims.").

For an example of an insurer who "never paid full policy limits regardless of the injuries," see TOBIAS, *supra* note 4, at 117 (emphasis in original). The company "adopted the philosophy that if someone wanted to settle a claim with them they would have to permit [the company] to save a little from the full policy limits." *Id.* Tobias relays other disturbing anecdotes about insurance companies' settlement practices, such as a story of one insurer that "had a quota aimed at denying half its disability claims," *id.* at 122, and a story about an insurer that contracted with its policyholders to cover funeral expenses, but then "indicat[ed] that it was their practice with regard to funeral expenses not to pay for the cemetery plot, clergyman or flowers," *id.*

10. See Nader, *supra* note 1, at ix ("When small claims are rejected by the adjuster, most people give up in disgust. *This is exactly what the insurance companies want you to do.* Think about the millions of honest claims that are never challenged, and you can understand the surge of wealth generated by most major insurance companies.") (emphasis in original).

recognize the tort of bad faith.<sup>11</sup> Over the years, courts realized that the traditional rules of contract cannot sufficiently protect the peculiar needs of a client in an insurance contract.<sup>12</sup> Traditional, arms-length contract principles still govern some portions of insurance law, but courts increasingly recognize that the relationship between an insurer and its insured is at times fiduciary in nature.<sup>13</sup> Insureds rely heavily on insurers, who are inherently wealthier and better situated to incur the financial risks of litigation.<sup>14</sup> Thus, courts bestowed on insureds a powerful right to punish insurers who manipulate their positional superiority to take advantage of their insureds—the bad faith cause of action.<sup>15</sup> The bad faith cause of action gives policyholders their greatest means of rebuking insurers' inappropriate conduct.<sup>16</sup>

Because insurance companies seem increasingly willing to routinely deny claims to increase company profits,<sup>17</sup> the remedies available to civil litigants become of the utmost importance—those wronged by insurance companies need rights to punish the companies' egregious behavior.<sup>18</sup> This Note examines the rights that civil litigants possess against insurance companies in the state of Indiana. This Note posits that Indiana's state law would benefit by granting third-party judgment creditors<sup>19</sup>

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11. See SHERNOFF, *supra* note 2, at 16. The tort of bad faith is an alternative to contract damages for an insurer's failure to perform its contractual duties in good faith. KIMBALL, *supra* note 4, at 486. "[M]ost states now recognize a separate cause of action in tort based upon breach of an independent, judicially imposed duty to fulfill contractual obligations in good faith." *Id.*

12. See Daniel S. Bopp, *Tort and Contract in Bad Faith Cases: Is the Honeymoon Over?*, 59 DEF. COUNS. J. 524, 524 (1992).

13. See *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 518 (Ind. 1993).

14. See SHERNOFF, *supra* note 2, at 17; see also Bopp, *supra* note 12, at 527. The common policyholder probably purchases insurance with the idea that her relationship with her insurer will be fiduciary in nature. See Nader, *supra* note 1, at xi. When contracting with an insurance company, most people believe that they are purchasing protection, rather than "a lot of vexatious, time-consuming, expensive litigation with [the] insurer." *Hayseeds, Inc. v. State Farm Fire & Cas.*, 352 S.E.2d 73, 79 (W. Va. 1986); see also SHERNOFF, *supra* note 2, at 14.

15. See KIMBALL, *supra* note 4, at 486-88; see also SHERNOFF, *supra* note 2, at 16; Bopp, *supra* note 12, at 526. The bad faith cause of action was borne out of a contractual relationship between the insurer and the insured, but the action itself sounds in tort. Bopp, *supra* note 12, at 524-25.

16. See SHERNOFF, *supra* note 2, at 16.

17. *Id.* at 14, 17; see also Nader, *supra* note 1, at xi; *supra* notes 9-10 and accompanying text.

18. SHERNOFF, *supra* note 2, at 16-19.

19. If a defendant loses the underlying case and owes a debt to the plaintiff from the underlying case, then the defendant becomes a "judgment debtor"; the plaintiff that won the underlying case becomes a "judgment creditor." See BLACK'S LAW DICTIONARY 848 (7th ed. 1999). See generally *Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482, 485 (Ind. Ct. App. 1998); MAGARICK, *supra* note 4, § 9.04, at 9-26 to 9-29; Willy E. Rice, *Judicial Bias, the Insurance Industry and Consumer Protection: An Empirical Analysis of State Supreme Courts' Bad-Faith, Breach-of-Contract, Breach-of-Covenant-of-Good-Faith and Excess-Judgment Decisions, 1900-1991*, 41 CATH. U. L. REV. 325, 346 n.87 (1992).

enhanced rights against insurers, because such rights would provide incentives for insurers to deal with their policyholders in good faith. This Note then offers a two-part proposal to improve Indiana's insurance law that would enhance judgment creditors' rights without extending insurers' duties past the duties they already owe to their policyholders.

Specifically, Part II of this Note will outline some relevant background information describing the difference between first-party and third-party insurance. Part III will then discuss the development of the law of bad faith and highlight certain differences and innovations in the bad faith law of different jurisdictions. Part IV will next discuss the development of the bad faith tort law in Indiana; this Part will also identify certain areas of concern that exist in Indiana's current bad faith law. Finally, Part V will draw upon the discussions from Parts III and IV to suggest modifications of Indiana's bad faith tort law that would hold insurers more accountable for inappropriate dealings with their policyholders.

## II. BACKGROUND: FIRST-PARTY VS. THIRD-PARTY INSURANCE

The relationship of the parties in an insurance lawsuit affects the rights and liabilities between the parties.<sup>20</sup> First-party insurance entails situations where an insurer contracts with an insured to reimburse that person for all losses to her property that are protected under the limits of her insurance contract.<sup>21</sup> Common examples of first-party insurance policies are fire insurance on a home or automobile collision insurance.<sup>22</sup>

Conversely, with third-party insurance, rather than reimbursing an insured for her own losses, an insurer covers any liability the insured may incur by inflicting damages on a third party.<sup>23</sup> Third-party insurance, therefore, involves situations where an insurer contracts with an insured to pay covered claims brought against the insured by a third-party claimant.<sup>24</sup> An example of a third-party insurance policy is automobile liability insurance.<sup>25</sup> With third-party insurance, the insurer indemnifies its insured for judgments or settlements up to the limits of the insured's insurance policy.<sup>26</sup> Additionally, the insurer in a liability insurance policy assumes a duty to defend

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20. See Bopp, *supra* note 12, at 524.

21. Thomas V. Flaherty et al., *Developments in West Virginia's Insurance Bad Faith Law—Where Do We Go From Here?*, 98 W. VA. L. REV. 267, 269 (1995).

22. *Id.*

23. *Id.* A "third party," in this context, is any person outside of the relationship between the insurer and those insured under the insurance policy. Brian Neff, *Third-Party Claimants and an Insurer's Duty of Good Faith and Fair Dealing*, 1992 UTAH L. REV. 274, 279 n.38 (1992).

24. Flaherty et al., *supra* note 21, at 269. A "third-party claimant" is a party outside of the insurance contract between the insurer and its insured; the third-party claimant typically brings suit against the insured. See *id.* at 282-83, 292; see also Neff, *supra* note 23, at 281-82. But, some third-party claimants also attempt to bring suit directly against the insurer. Flaherty et al., *supra* note 21, at 292.

25. Flaherty et al., *supra* note 21, at 269.

26. *Id.* at 269-70.

lawsuits brought against its insured;<sup>27</sup> thus, liability insurance gives the insurer the right to conduct any defense or to enter into any settlements for claims brought against its insured.<sup>28</sup>

Although an insurer's acts of bad faith may result in tort liability in both the first-party and third-party contexts,<sup>29</sup> the remainder of this Note will discuss bad faith in the third-party context because the third-party context is where Indiana could improve its insurance law to enhance the rights of judgment creditors and to provide stronger deterrents against bad faith acts by insurers.

### III. DEVELOPMENT OF BAD FAITH TORT LAW IN THE THIRD-PARTY CONTEXT

As bad faith tort law continues to develop, courts face the task of resolving the rights and liabilities between the parties to an insurance dispute. With every expansion of the law, courts in turn must adjust and redefine these rights and liabilities. This Part traces this development of bad faith tort law. Part A explains the typical fact situation in which bad faith disputes arise; Part B summarizes the initial development of third-party bad faith law; and Part C explains the rights and liabilities running among the various parties to a bad faith dispute. This Part explores the development of the tort of bad faith and the differences that arose between various jurisdictions so that Part IV may later compare Indiana's bad faith doctrine with other existing doctrines. After Part IV compares the existing doctrines, Part V will draw upon the doctrines from other jurisdictions to suggest changes to improve Indiana's bad faith law.

#### A. Situations That Give Rise to Third-Party Bad Faith Actions

In insurance law, the tort of bad faith developed first in the third-party context.<sup>30</sup>

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27. KIMBALL, *supra* note 4, at 485; *see also* Flaherty et al., *supra* note 21, at 270. When an insurer assumes a duty to defend an insured under a third-party liability insurance contract, the insurer also assumes a duty to pay the costs of the defense of any lawsuit brought against the insured. Flaherty et al., *supra* note 21, at 270.

28. Flaherty et al., *supra* note 21, at 270.

29. *See* Bopp, *supra* note 12, at 525-27. An insurer may violate its duty of good faith in many ways, with violations resulting in causes of action for both policyholders and third parties. Rice, *supra* note 19, at 333. The most obvious way that an insurer may violate its duty of good faith is through "a breach of the express terms of the insurance policy." *Id.* Additional potential violations include:

attempting to settle a claim without giving notice to the insured; compelling an insured to sue; delaying the investigation of a claim; delaying the payment of a claim; denying coverage outright; failing to acknowledge claims; failing to inform insured about the status of benefits; failing to investigate a claim; failing to defend a suit; failing to process a claim in a timely fashion; failing to settle claim in a timely manner; failing to settle within policy limits; intentionally inflicting emotional distress; refusing to issue a policy; refusing to pay a first-party claim; refusing to pay a third-party claim; and, terminating an employment contract.

*Id.* at 333 n.25 (citations omitted).

30. Bopp, *supra* note 12, at 525-26; *see also* Flaherty et al., *supra* note 21, at 282.

In this third-party context, the typical fact pattern which creates a claim of bad faith against an insurer occurs when an insured inflicts damages on a third party, who then sues the insured for an amount that exceeds the insured's liability insurance policy limits.<sup>31</sup> In this situation, the insurer normally defends the case on behalf of its insured, which also means that the insurer makes any decisions whether to settle the claim.<sup>32</sup> When an insurer steps in to defend one of its insureds, however, the insurer's interests in defending the case often conflict with the interests of the insured who is being sued.<sup>33</sup>

For instance, if the third party offers to settle its claim at or near the insured's policy limit, the insured might want to settle the case, end her liability within her policy limits, and end the hassle of a pending lawsuit.<sup>34</sup> However, the insurer might choose not to accept the settlement offer because the company has little to lose by proceeding to trial.<sup>35</sup> The most that the insurer will have to pay in a contract action is its insured's policy limits, and, by going to trial, the insurer gives itself a chance of obtaining a verdict in its favor.<sup>36</sup> The insured, on the other hand, has much to lose by proceeding to trial.<sup>37</sup> An adverse verdict may subject the insured to a judgment that far exceeds her policy limits.<sup>38</sup>

With this inequality in mind, courts began to give insureds a tort remedy for an insurer's failure to act in good faith on behalf of the best interests of its insureds.<sup>39</sup> If an insured might be subjected to a potential liability that would exceed her insurance policy limits, courts imposed a duty on the insurer to subordinate its interests to the interests of the insured—even if this is to the financial detriment of the insurer—because the insured, by purchasing her insurance policy, has bargained for a contract that guarantees that the insurer will protect her interests against any liability that she may incur by inflicting damages on others.<sup>40</sup> Thus, if the case proceeds to trial and the third party obtains a judgment against the insured that exceeds the insured's policy limits (that is, a judgment that is greater than the original settlement offer), then the insured would have a new cause of action against her insurer for the company's failure to settle the original, underlying claim in good faith.<sup>41</sup>

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31. Flaherty et al., *supra* note 21, at 282-83.

32. *Id.* at 283.

33. *See* KIMBALL, *supra* note 4, at 487.

34. *See id.*; *see also* Bopp, *supra* note 12, at 525; Flaherty et al., *supra* note 21, at 283.

35. KIMBALL, *supra* note 4, at 487.

36. *Id.* Or, instead of obtaining a verdict in the insured's favor, the insurer may proceed to trial in hopes of obtaining a verdict holding that the insured is liable on grounds not covered by the insurance policy, which would absolve the insurer of any responsibility to the insured. In that situation, "[t]he insurer's best chance to optimize its own interests in the individual case might then be to sacrifice the insured rather than to defend vigorously and whole-heartedly." *Id.* 534.

37. Flaherty et al., *supra* note 21, at 283.

38. Bopp, *supra* note 12, at 525; *see also* Flaherty et al., *supra* note 21, at 283.

39. Bopp, *supra* note 12, at 525.

40. *Id.* at 525.

41. KIMBALL, *supra* note 4, at 486 ("Partly because the insurer usually has a nearly unlimited right to settle, it has a correlative obligation to perform its duties and exercise its

*B. The Origins of an Insurer's Duty of Good  
Faith in the Third-Party Context*

In the first half of the twentieth century, courts began to recognize that insurers had a duty to settle when settlement is in the best interests of their insureds.<sup>42</sup> Insurers became liable to their insureds when a company's decision to proceed to trial resulted in an excess verdict against one of its policyholders.<sup>43</sup> With *Comunale v. Traders & General Insurance Co.*,<sup>44</sup> California became the first state to make an insurer's duty to act in good faith on behalf of its policyholders an implied part of the actual insurance contract.<sup>45</sup> The California Supreme Court stated that an insurer's "implied obligation of good faith and fair dealing requires the insurer to settle in an appropriate case[,] although the express terms of the policy do not impose such a duty."<sup>46</sup> The majority of jurisdictions followed this trend and now allow bad faith causes of action in the third-party context.<sup>47</sup> Indiana also followed this trend and accepted this cause of action with *Erie Insurance Co. v. Hickman by Smith*<sup>48</sup> and its progeny.<sup>49</sup>

*C. Parties That May Bring an Action  
Based on an Insurer's Bad Faith*

After courts recognized the existence of the duty of good faith, they then began the task of determining which parties may bring an action for an insurer's breach of that duty. Nearly all jurisdictions allow insureds to bring a bad faith tort action against an insurer.<sup>50</sup> Likewise, most jurisdictions allow an assignee of the insured's claim to bring the claim against an insurer.<sup>51</sup> However, third parties (whether they are third-party claimants<sup>52</sup> or third-party judgment creditors<sup>53</sup>) rarely may bring a claim against

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privileges fairly. Failure to do so may lead to liability for bad faith."); *see also* MAGARICK, *supra* note 4, § 9.01 at 9-1; Bopp, *supra* note 12, at 525; Flaherty et al., *supra* note 21, at 282-83.

42. Flaherty et al., *supra* note 21, at 283.

43. *Id.*

44. 328 P.2d 198 (Cal. 1958).

45. *Id.* at 200; *see also* Bopp, *supra* note 12, at 526. Although this Note discusses only the insurer's duty of good faith, "[g]ood faith is an implied duty and should be applicable to both parties equally." MAGARICK, *supra* note 4, § 9.02, at 9-4.1.

46. *Comunale*, 328 P.2d at 201.

47. *See Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 519 & n.2 (Ind. 1993) ("[T]he majority of states recognize a cause of action in tort in the context of third-party claims . . ."); *see also* MAGARICK, *supra* note 4, § 9.01, at 9-1.

48. 622 N.E.2d 515 (Ind. 1993).

49. *Erie*, 622 N.E.2d at 519; *see also* Gooch v. State Farm Mut. Auto. Ins. Co., 712 N.E.2d 38, 39-41 (Ind. Ct. App. 1999); Dimitroff v. State Farm Mut. Auto. Ins. Co., 647 N.E.2d 339, 341 (Ind. Ct. App. 1995).

50. *See infra* Part III.C.1.

51. *See infra* Part III.C.2.

52. *See infra* Part III.C.3.

53. *See infra* Part III.C.4.

an insurer without an assignment from an insured. The following subparts explore more thoroughly how a party's position in the case affects that party's right to bring a bad faith cause of action.

### 1. Insureds

Courts have willingly recognized an insurer's duty to act in good faith toward its insureds in the third-party liability context because of the unique relationship of the parties to an insurance contract.<sup>54</sup> The contractual relationship between an insurer and an insured "is at times a traditional arms-length dealing between two parties, as in the initial purchase of a policy, but is also at times one of a fiduciary nature."<sup>55</sup> An insurer's duty of good faith "arises because an insured purchases a policy to obtain protection from claims made by third parties,"<sup>56</sup> and, in doing so, "[t]he insured typically surrenders to the insurer the right to control the defense and settlement of the litigation."<sup>57</sup> Since the insured places control of its lawsuit in the hands of the insurer, the insurer consequently must make "an aggressive good faith effort to settle and protect its insured."<sup>58</sup> The part of the insurance liability contract that requires an insurer to defend its insured imposes on the insurer a fiduciary responsibility to act in

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54. Bopp, *supra* note 12, at 524; *see, e.g., Erie*, 622 N.E.2d at 518-19.

55. *Erie*, 622 N.E.2d at 518. Notice that the Supreme Court of Indiana used the term "of a fiduciary nature" in *Erie*, because an insurance company does not maintain a true fiduciary relationship with its insureds, MAGARICK, *supra* note 4, § 12.16, at 12-25, as does a trustee with a beneficiary of a trust, a guardian with a ward, an agent with a principal, or an attorney with her client, *see generally* BLACK'S LAW DICTIONARY 640 (7th ed. 1999). Nevertheless, many commentators analogize the insurer's duty of good faith to a fiduciary duty owed to its insureds. *See, e.g.,* MAGARICK, *supra* note 4, § 12.16, at 12-23 to 12-24 ("There is no doubt that an insurer has a fiduciary duty to look after the interests of its insured when evaluating an offer of settlement within the policy limits. Failure of an insurer to inform its insured of offers to settle within the policy limits has been held to be bad faith in violation of its fiduciary relationship."). The insurer's "special relationship" with its insured, *Erie*, 622 N.E.2d at 518, whether termed a fiduciary duty or a duty of good faith, imposes on the insurer many affirmative duties. For example:

To handle an insured's defense in good faith, the insurer must do several things: it must determine whether the complaint against the insured states facts that could potentially lead to liability falling within the policy coverage and, if so, proceed with the defense; it must not withdraw from the insured's defense in bad faith; it must handle the mechanical aspects of the insured's defense (investigation, depositions, settlement negotiations, conduct at trial, etc.) in good faith. Then, if liability and coverage are established, the insurer must pay without inappropriate resistance or delay.

KIMBALL, *supra* note 4, at 486-87.

56. Flaherty et al., *supra* note 21, at 294.

57. *Id.*

58. *Id.* at 293-94 (quoting *Shamblin v. Nationwide Mut. Ins. Co.*, 396 S.E.2d 766, 773 (W. Va. 1990)).

good faith toward its insured.<sup>59</sup>

An insurer's duty of good faith requires the insurer to safeguard its insureds' interests as if it were looking after its own interests.<sup>60</sup> By extending a duty of good faith from insurer to insured, courts bolster policyholders' chances of receiving the contractual benefits that they purchased from their insurers.<sup>61</sup> Because this duty promotes performance of the contract, it is no wonder that courts willingly offered this means for an insured to recover for its insurer's failure to fulfill the duty of good faith. Today, the vast majority of jurisdictions recognize an insured's right to bring an action against its insurer if the insurer breaches its duty of good faith.<sup>62</sup>

## 2. Assignees

After an insurer's acts of bad faith result in an excess judgment against its insured, courts almost unanimously allow the insured to bring an action against its insurer.<sup>63</sup> Moreover, if the insured has assigned<sup>64</sup> its rights to bring the action against the insurer to the injured third party (the original claimant), most courts allow the third party (now the "assignee") to bring the action in its own name against the insurer.<sup>65</sup> For the third party to gain this right to a cause of action against the insurer by assignment, the insured must first be harmed by the insurer's bad faith failure to settle the underlying claim against the insured.<sup>66</sup> This gives the insured a cause of action against the insurer, which, in many states, the insured may then assign to a third party.<sup>67</sup> The third party may then step into the shoes of the insured and bring the action

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59. Neff, *supra* note 23, at 279 (quoting *Ammerman v. Farmers Ins. Exch.*, 430 P.2d 576, 578 (Utah 1967)).

60. *Id.*

61. Flaherty et al., *supra* note 21, at 296.

62. *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515, 519 & n.2 (Ind. 1993); *see also* MAGARICK, *supra* note 4, § 9.01, at 9-1; Eugene R. Anderson & Joshua Gold, *Assignment of Insurance Claims by Policyholders to Underlying Claimants*, 1 PRACTISING L. INST. 687, 715 (1997); Rice, *supra* note 19, at 344.

63. MAGARICK, *supra* note 4, § 9.01, at 9-1; *see also* Anderson & Gold, *supra* note 62, at 713; Rice, *supra* note 19, at 344.

64. "An assignment is a transfer or setting over of property, or of some right or interest therein, from one person to another." ALEXANDER M. BURRILL, *A TREATISE ON THE LAW AND PRACTICE OF VOLUNTARY ASSIGNMENTS FOR THE BENEFIT OF CREDITORS* § 1, at 1 (James Avery Webb ed., 6th ed. 1894), *quoted in* BLACK'S LAW DICTIONARY 115 (7th ed. 1999). For an example of an assignment agreement, *see Economy Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 384 (Ind. Ct. App. 1995).

65. MAGARICK, *supra* note 4, § 9.02, at 9-2; *see, e.g., Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 202 (Cal. 1958); *see also* Anderson & Gold, *supra* note 62, at 691-92; Rice, *supra* note 19, at 344-45.

66. *See* MAGARICK, *supra* note 4, § 9.02, at 9-2; *see also* Flaherty et al., *supra* note 21, at 282-83; *supra* Part III.A.

67. MAGARICK, *supra* note 4, § 9.02, at 9-2; *see also* Anderson & Gold, *supra* note 62, at 692; Rice, *supra* note 19, at 344-45.

as if it were her own.<sup>68</sup> In consideration for the assignment, the insured may receive a covenant from the third party to no longer hold the insured liable for the underlying claim.<sup>69</sup> Thus, with an assignment, the insured relieves itself of liability for the excess judgment, and the injured third party enjoys a means of reaching the deep pockets of the insurance company, which is especially important when an insolvent insured cannot pay the full amount of the excess judgment.<sup>70</sup>

Although the majority of courts allow the assignment of at least some rights from the insured to the third party, courts are anything but unanimous concerning what types of claims (that is, tort claims or contract claims) are assignable and what types of damages (that is, pecuniary damages,<sup>71</sup> consequential and/or compensatory damages,<sup>72</sup> bad faith tort damages, or punitive damages) are recoverable from the insurer after the assignment.<sup>73</sup> This division between the courts concerning assignment developed due to the differing ways courts construe a breach of the covenant of good faith in an insurance contract.<sup>74</sup> Some jurisdictions interpret the cause of action that results from a breach of the insurer's covenant of good faith as a breach of contract, while others construe the cause of action as a tort.<sup>75</sup>

How a court interprets the cause of action—whether as a breach of contract or a tort—affects the claim's assignability.<sup>76</sup> Contract claims are normally assignable,<sup>77</sup> but

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68. MAGARICK, *supra* note 4, § 9.02, at 9-2; *see also* Anderson & Gold, *supra* note 62, at 692.

69. MAGARICK, *supra* note 4, § 9.02[2], at 9-15 to 9-16; *see also* Anderson & Gold, *supra* note 62, at 694-95, 695 n.10 (“To settle the tort claim and to ameliorate the effects of an insurance coverage denial, a policyholder will typically assign its rights under its liability policy to the underlying claimant in exchange for a covenant by the claimant not to execute on any judgment against the policyholder.”). For an example of an assignment agreement, *see Economy Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 384 (Ind. Ct. App. 1995).

70. *See* MAGARICK, *supra* note 4, § 9.04, at 9-27 to 9-28; *see also* Rice, *supra* note 19, at 344-45, 345 n.84.

71. A pecuniary loss is a “loss of money or of something having monetary value.” BLACK’S LAW DICTIONARY 957 (7th ed. 1999). In the third-party insurance context, the insured’s pecuniary damages are the amount of the excess judgment. *See Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482, 485 (Ind. Ct. App. 1998).

72. *See* JOHN C. MCCARTHY, RECOVERY OF DAMAGES FOR BAD FAITH § 2.65, at 471-73 (5th ed. 1990).

73. *See* MAGARICK, *supra* note 4, § 10.02[1], at 10-7 to 10-8; *see also* Anderson & Gold, *supra* note 62, at 713-714; Rice, *supra* note 19, at 333 (“[B]oth the amount and the types of damages recoverable under an implied covenant of good faith seriously divide state supreme courts.”).

74. *See* Rice, *supra* note 19, at 334 (citing *State Farm Fire & Cas. Co. v. Nicholson*, 777 P.2d 1152, 1154-1155 (Alaska 1989)).

75. *Id.*; *see also* Anderson & Gold, *supra* note 62, at 716.

76. *See generally* Anderson & Gold, *supra* note 62, at 715-16; Rice, *supra* note 19, at 344-50.

77. *See* MAGARICK, *supra* note 4, § 9.02, at 9-2; *see also* Anderson & Gold, *supra* note 62, at 716; Rebecca J. Seamands, “*Lawsuit for Sale*”: *An Analysis of the Assignability of Legal Malpractice Claims*, 25 IND. L. REV. 257, 266 (1991).

doubts exist as to the assignability of certain types of tort claims.<sup>78</sup> If the insured's claim against the insurer is construed as a tort claim, some courts disallow assignment of the tort because, as a general rule, torts for personal injuries are not assignable.<sup>79</sup> However, the majority of courts do allow the assignment of a bad faith tort claim<sup>80</sup>—often because the court will construe the underlying injury as an injury to the insured's property, rather than as an injury to the insured's person.<sup>81</sup> Actions from a tort to real or personal property are assignable.<sup>82</sup> Courts are willing to allow such an assignment of a tort claim because the assignment satisfies the reasonable expectations of the insured—that it will not be held liable for an excess judgment.<sup>83</sup> Despite some lingering differences between jurisdictions, most courts hold that bad faith causes of action are assignable whether the action is based in contract or in tort.<sup>84</sup>

The manner in which a court construes a breach of an insurance contract may also affect the damages available following an assignment. The general rule is that punitive damages are not available in a breach of contract claim, and some courts hold that this is true even for claims based on an insurer's bad faith breach of an insurance contract.<sup>85</sup> Accordingly, if the insured's claim against the insurer is strictly construed as a contract claim, some courts only allow recovery for the amount of the policy limits on the insurance contract.<sup>86</sup> If, however, the insured's claim is construed as an independent tort claim, some courts will allow recovery for consequential damages (due to "economic loss and emotional distress") plus punitive damages.<sup>87</sup> Still other courts confusingly allow plaintiffs in breach of contract actions to pursue all of the damages available in a tort claim, including punitive damages.<sup>88</sup> Visibly, courts may choose from many different theories of recovery to augment their bad faith insurance law; but, regardless of which theory a particular court chooses, it should express its theory clearly and decisively to help litigants decide which damages to seek and whether their case is one in which an assignment is allowed.<sup>89</sup>

As is evident, the manner in which a court construes the claim that develops as

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78. See MAGARICK, *supra* note 4, § 9.02, at 9-2; see also Anderson & Gold, *supra* note 62, at 713-716; Rice, *supra* note 19, at 344-46.

79. MAGARICK, *supra* note 4, § 9.02, at 9-4.2; see, e.g., Allstate Ins. Co. v. Axsom, 696 N.E.2d 482, 485 (Ind. Ct. App. 1998); see also Anderson & Gold, *supra* note 62, at 713-714, 716; Rice, *supra* note 19, at 344 ("As most first-year law students discover, the common-law is fairly settled on one point: *personal-injury tort claims are not assignable.*") (emphasis in original).

80. Anderson & Gold, *supra* note 62, at 716; see also Rice, *supra* note 19, at 344.

81. MCCARTHY, *supra* note 72, § 2.60, at 455-56.

82. *Id.*; see also Seamands, *supra* note 77, at 266.

83. Rice, *supra* note 19, at 344-45.

84. MAGARICK, *supra* note 4, § 9.02, at 9-2; see also Anderson & Gold, *supra* note 62, at 715-17; Rice, *supra* note 19, at 344-45.

85. MAGARICK, *supra* note 4, § 19.02, at 19-16.

86. See Rice, *supra* note 19, at 333-34, 334 n.26 (citing Santilli v. State Farm Life Ins. Co., 562 P.2d 965, 969 (Or. 1977)).

87. *Id.* at 334.

88. *Id.*

89. *Id.* at 345.

a result of an insurer's breach of its duty of good faith greatly affects the rights of the parties involved. Nevertheless, "assignability . . . is now the rule; nonassignability, the exception."<sup>90</sup>

### 3. Third-Party Claimants

After courts commonly accepted insureds' and assignees' rights to bring bad faith tort claims against insurers,<sup>91</sup> third-party *claimants* then began to bring actions based on bad faith directly against insurers.<sup>92</sup> Like an assignee, third-party claimants are plaintiffs that are outside of the original contract between the insurer and the insured.<sup>93</sup> But, unlike an assignee, a third-party claimant brings a claim directly against the insurer without first winning an underlying case and receiving an assignment from the insured.<sup>94</sup> Moreover, a third-party claimant does not hold an executory judgment<sup>95</sup> against the insured, as does a judgment creditor.<sup>96</sup> By suing insurers, third-party claimants essentially asked courts to extend the insurer's duty of good faith to include an adversarial plaintiff who is suing the insurer's client<sup>97</sup>—the same client that the insurer is supposed to protect.<sup>98</sup> Despite the potential conflicts that would arise for an insurer if it were held both to a duty of good faith toward third-party claimants and to a duty to act in the best interests of its insureds,<sup>99</sup> third-party claimants attempted to justify the extension of this duty by professing to be third-party *beneficiaries*<sup>100</sup> of the contract between the insurer and the insured.<sup>101</sup> Courts, however, overwhelmingly rejected third-party claimants' attempts to associate themselves with the insurance

90. Seamands, *supra* note 77, at 266; *see, e.g.* Allstate Ins. Co. v. Axsom, 696 N.E.2d 482, 485 (Ind. Ct. App. 1998) ("[T]he types of torts which may not be assigned have become so narrow that [the] nonassignability of tort actions is now the exception while assignability is the general rule.").

91. *See supra* Parts III.C.1, III.C.2.

92. Flaherty et al., *supra* note 21, at 292; *e.g.*, Dimitroff v. State Farm Mut. Auto. Ins. Co., 647 N.E.2d 339, 342 (Ind. Ct. App. 1995); Eichler v. Scott Pools, Inc., 513 N.E.2d 665, 667-68 (Ind. Ct. App. 1987); *see also* Neff, *supra* note 23, at 279.

93. *See* MAGARICK, *supra* note 4, § 9.03, at 9-20 to 9-26; *see also* Flaherty et al., *supra* note 21, at 292; Neff, *supra* note 19, at 282-83.

94. *See* MAGARICK, *supra* note 4, § 9.03, at 9-20 to § 9.05, at 9-32.

95. An executory judgment is "[a] judgment that has not been carried out." BLACK'S LAW DICTIONARY 846 (7th ed. 1999).

96. *See* MAGARICK, *supra* note 4, § 9.03, at 9-20 to 9-21; *see also* Flaherty et al., *supra* note 21, at 292; Neff, *supra* note 23, at 282-83.

97. Neff, *supra* note 23, at 279.

98. *See supra* Part III.B.

99. Flaherty et al., *supra* note 21, at 296-99.

100. A third-party beneficiary is "[a] person who, though not a party to a contract, stands to benefit from the contract's performance." BLACK'S LAW DICTIONARY 149 (7th ed. 1999).

101. *See, e.g.*, Eichler v. Scott Pools, Inc., 513 N.E.2d 665, 667 (Ind. Ct. App. 1987); *see* Neff, *supra* note 23, at 279-80. Third-party beneficiaries are typically parties other than the insured that are actually covered by the insured's policy, such as passengers in an insured's automobile. *See* Snow v. Bayne, 449 N.E.2d 296, 298-99 (Ind. Ct. App. 1983).

contract,<sup>102</sup> categorizing them instead as adversarial claimants.<sup>103</sup> Therefore, almost all jurisdictions, including Indiana,<sup>104</sup> declined to extend an insurer's duty of good faith to third-party claimants.<sup>105</sup>

The primary reason courts refused to extend an insurer's duty of good faith to cover third-party claimants is because an insurer's duty of good faith develops from the contractual relationship between the insurer and its policyholders, and a third-party claimant has no contractual relationship with the insurer.<sup>106</sup> Unlike the relationship between an insurer and an insured, the relationship between an insurer and a third-party claimant lacks the bargained-for rights that come with the endorsement of an insurance contract.<sup>107</sup> A third-party claimant has neither bargained-for nor purchased any insurance protection from the insurer.<sup>108</sup> Nor has a third-party claimant given the insurer the right to conduct litigation on the claimant's behalf.<sup>109</sup> Transactions between insurance companies and third-party claimants take place at arm's length, without any of the fiduciary-like duties that sometimes run from insurer to insured.<sup>110</sup>

Furthermore, the interests of the insured conflict with the interests of the third-party claimant—the insurer cannot help one party without hurting the other.<sup>111</sup> In other words, if an insurer were held to a duty of good faith both to a third-party claimant and to its insured, the insurer could not act in the best interests of one party without compromising the interests of the other.<sup>112</sup> A judicial policy that requires an insurer

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102. Flaherty, *supra* note 21, at 294; *e.g.*, Eichler, 513 N.E.2d at 667 (“A claimant has no standing to sue the defendant’s insurer for handling a claim negligently or in bad faith. There is no duty running from the insurer to the claimant to settle a claim, nor is the claimant a third-party beneficiary of the duty owed the insured by the insurer.”) (citations omitted); *see also* Neff, *supra* note 23, at 280.

103. *See* Flaherty et al., *supra* note 21, at 296-97.

104. *E.g.*, Dimitroff v. State Farm Mut. Auto. Ins. Co., 647 N.E.2d 339, 342 (Ind. Ct. App. 1995); Eichler, 513 N.E.2d at 667-68.

105. MAGARICK, *supra* note 4, § 9.02, at 9-2; *see also* Flaherty, *supra* note 21, at 294 & n.130; Neff, *supra* note 23, at 280 & n.47. The states that do allow direct actions by third-party claimants usually do so by interpreting their state’s Unfair Claims Settlement Practices Act so that third-party claimants may bring a suit directly against an insurer. Timothy D. Beets, *Third-Party Direct Suits: Why Doesn’t Oklahoma Hold Automobile Liability Insurers as Accountable as Their Insureds?*, 24 OKLA. CITY U. L. REV. 315, 316 (1999).

106. MAGARICK, *supra* note 4, § 9.03, at 9-20 to 9-21; *e.g.*, Neff, *supra* note 23, at 280 (noting that the Utah Supreme Court refused to allow a third-party claimant to bring a bad faith action against an insurer because the third party “had no privity of contract with the insurer”) (citing *Ammerman v. Farmers Ins. Exch.*, 430 P.2d 576, 577 (Utah 1967)).

107. *See* Flaherty et al., *supra* note 21, at 296-97.

108. *Id.* at 294.

109. *Id.*

110. Neff, *supra* note 23, at 283; *supra* Part III.C.1.

111. Flaherty et al., *supra* note 21, at 296-97.

112. *Id.* at 297-99. For example, if a third-party claimant wants to settle but the insured believes that it did nothing wrong and would prefer rather to proceed to trial (in order to protect its insurance record or to keep its premiums down), the insurer must decide whose wishes to uphold and whose wishes to compromise. *Id.* at 297-98. If the insurer—acting in consideration

to compromise the interests of its insureds would directly defeat the purpose of the doctrine of good faith<sup>113</sup> expounded by *Comunale v. Traders & General Insurance Co.*<sup>114</sup> and its progeny—that an insurer should aggressively protect the interests of its insureds.<sup>115</sup> Therefore, because a third-party claimant is essentially a stranger to the insurance contract, the reasons for giving an insured a tort action for a breach of the duty of good faith do not exist for a third-party claimant to bring such an action.<sup>116</sup> Most courts understandably denied attempts by third-party claimants to expand the good faith law.

#### 4. Third-Party Judgment Creditors Without an Assignment: Florida Breaks New Ground

In 1971, the Supreme Court of Florida in *Thompson v. Commercial Union Insurance Co.*<sup>117</sup> held that judgment creditors could bring suit directly against an insurer without first receiving an assignment of such a right from the insured.<sup>118</sup> The *Thompson* decision seemed to convert all third parties in Florida into third-party beneficiaries of the contract between the insurer and the insured.<sup>119</sup> The court held that a third party's status as a third-party beneficiary allowed the third party to bring a direct action against the insurer when the insurer handled the suit in bad faith.<sup>120</sup>

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of a duty of good faith to third-party claimants—upholds the third-party claimant's wishes to settle, then the insured's wishes to defend the suit would be compromised. *Id.* at 298. This violates the insurer's requirement to aggressively uphold the interests of its insureds which is the very purpose of an insurer's duty of good faith to its insureds. *See id.* at 293-94, 297-99. Or, even when the insured and the third-party claimant both favor settlement, the preferred amount of the settlement could differ between the two parties. *Id.* at 298-99. The third-party claimant desires to settle for as much money as it can, and the insured has an interest in keeping the settlement low to preserve the rest of the money available under its policy in case additional claims are made against the policy. *Id.* Here, the insurer would likely choose a settlement amount in between the preferred amounts of the two parties, which effectively compromises the strongest wishes of both parties. *Id.* at 299. This also violates the insurer's primary requirement of behaving in furtherance of its duty of good faith to its insureds. *Id.*

113. *See id.* at 299.

114. 328 P.2d 198 (Cal. 1958).

115. *See id.* at 200-02; *see also* Flaherty et al., *supra* note 21, at 293-94.

116. Flaherty et al., *supra* note 21, at 294.

117. 250 So. 2d 259 (Fla. 1971).

118. *Id.* at 264.

119. *Id.* at 262, 264.

“[E]very automobile liability insurance policy should be construed as a third party beneficiary contract entitling a judgment creditor to recover in a direct action against the insured for the excess of his judgment over policy limits in those cases where the insurer is guilty of negligence or bad faith in handling the claim.”

*Id.* at 262 (quoting *Canal Ins. Co. v. Sturgis*, 114 So. 2d 469, 472 (Fla. Dist. Ct. App. 1959) (Wigginton, C.J., specially concurring)).

120. *Id.* at 264 (“[We] hold that a judgment creditor may maintain suit directly against [a] tortfeasor's liability insurer for recovery of the judgment in excess of the policy limits, based

After *Thompson*, Florida appeared to be the lone standout against the trend that declined to extend the duty of good faith from an insurer to third parties.<sup>121</sup> To some, the third party's status as a beneficiary of the insurance contract appeared to denote that a Florida insurer's duty of good faith extended to the third party.<sup>122</sup> This interpretation led legal scholars and courts in other jurisdictions to attack the position taken by the Supreme Court of Florida. Legal scholars interpreted *Thompson* to mean that Florida had adopted a position contrary to the majority of jurisdictions, which steadfastly disallowed third parties from bringing a direct action against an insurer.<sup>123</sup> Courts in other jurisdictions refused to adopt Florida's position when third parties pressed for such an extension of the law,<sup>124</sup> characterizing the *Thompson* decision as "legally and logically unsound."<sup>125</sup>

However, the Supreme Court of Florida refined the *Thompson* decision in a later decision, *Fidelity & Casualty Co. of New York v. Cope*.<sup>126</sup> In *Cope*, the Supreme Court of Florida explained that

[n]owhere in *Thompson* . . . did we change the basis or theory of recovery. We did not extend the duty of good faith by an insurer to its insured to a duty of an insurer to a third party. The basis for an action remained the damages of an insured from the bad faith action of the insurer which caused its insured to suffer a judgment for damages above his policy limits. *Thompson* merely allowed the third party to bring such action in his own name *without an assignment*.<sup>127</sup>

With this statement, the Supreme Court of Florida cleared up its position concerning the rights of a third party to bring an action directly against an insurer. *Cope* clarified that third-party claimants could not bring an action against an insurer in Florida.<sup>128</sup> Only after the third-party claimant became a *judgment creditor* could it step into the shoes of the insured and bring an action against the insurer based on the damages that the insurance company caused the insured in the underlying case.<sup>129</sup> With the *Cope*

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upon the alleged fraud or bad faith of the insurer in the conduct or handling of the suit.").

121. See Flaherty et al., *supra* note 21, at 294 & n.130; see also Neff, *supra* note 23, at 280-81.

122. Flaherty et al., *supra* note 21, at 294 & n.130.

123. Neff, *supra* note 23, at 280-81 ("Florida is the only state to fully recognize a judgment creditor's right to claim the benefit of the insurer's good faith duty to its insured. That position has been widely attacked in other jurisdictions.") (citation omitted); see also Flaherty et al., *supra* note 21, at 294 & n.130.

124. See, e.g., *Page v. Allstate Ins. Co.*, 614 P.2d 339, 340 (Ariz. Ct. App. 1980) (Howard, J., concurring); *Bennett v. Slater*, 289 N.E.2d 144, 148 (Ind. Ct. App. 1972); Neff, *supra* note 23, at 281 n.49.

125. *Page*, 614 P.2d at 340 (Howard, J., concurring).

126. 462 So.2d 459 (Fla. 1985)

127. *Id.* at 460-61 (emphasis added).

128. *Id.* at 461.

129. *Id.*; see also *McLeod v. Cont'l Ins. Co.*, 591 So. 2d 621, 625 n.6 (Fla. 1992) (construing *Thompson* and *Cope*). To be fair, the *Thompson* decision held only that a

decision, the Supreme Court of Florida distanced itself somewhat from the position that had been heavily criticized by both legal scholars and by courts in other jurisdictions.<sup>130</sup> At the same time, however, the *Thompson* and *Cope* decisions distinguished Florida from the rest of the nation by eliminating a judgment creditor's need to receive an assignment from the judgment debtor as a prerequisite to a suit directly against the insurer.<sup>131</sup>

*Cope* rephrased Florida's bad faith insurance doctrine so that Florida's law did not appear quite as opposed to the insurance doctrine of other states. *Cope* cleared up any confusion that may have existed after *Thompson* by declaring that, in Florida, insurers have no duty to deal with third-party claimants in good faith.<sup>132</sup> The *Thompson* and *Cope* decisions merely allow third-party judgment creditors to bring an action against an insurer to collect the damages of an insured.<sup>133</sup> Florida justified its decision to allow a judgment creditor to sue an insurer without an assignment from the insured because the *Thompson* and *Cope* courts maintain that a liability insurance policy is meant to offer protection for the benefit of the injured third party as well as for the insured.<sup>134</sup> Under the reasoning of the *Thompson* and *Cope* courts, the implied covenant of good faith in a liability insurance contract carries with it an additional protection that most jurisdictions do not recognize—protection for an injured third party from an insured's insolvency.<sup>135</sup> Thus, the *Thompson* and *Cope* decisions represent a clear attempt by the Supreme Court of Florida to extend Florida's insurance law without offending the policies that are important to most commentators on bad faith insurance law.

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"*judgment creditor* may maintain suit directly against [a] tortfeasor's liability insurer for recovery of the judgment in excess of the policy limits . . ." *Thompson v. Commercial Union Ins. Co.*, 250 So. 2d 259, 264 (Fla. 1971) (emphasis added). However, the radical nature of the new rights bestowed on third parties in Florida following *Thompson* may have led some to believe that Florida extended an insurer's duty of good faith to cover a third party. *See Flaherty et al.*, *supra* note 21, at 294 & n.130.

130. Indeed, other sources continued to take exception to *Thompson* because Florida still allowed a judgment creditor to bring a claim against an insurer without an assignment from the insured. *See Neff*, *supra* note 23, at 280-81, 281 n.49. But, at least *Cope* cleared up any ambiguity that may have existed as to the duty (i.e. the lack thereof) owed by an insurer to a third party in Florida. *See Cope*, 462 So. 2d at 460-61.

131. *See Cope*, 462 So. 2d at 461; *see also Thompson*, 250 So. 2d at 264.

132. *Cope*, 462 So. 2d at 461.

133. *Id.*

134. *See Cope*, 462 So. 2d at 460-61; *see also Thompson*, 250 So. 2d at 262; MAGARICK, *supra* note 4, § 9.05, at 9-31; Rice, *supra* note 19, at 346 ("Liability insurance is purchased primarily to recompense injured third parties. Therefore, one would expect such parties to have little difficulty obtaining the right to commence direct-action suits against liability carriers for extracontractual damages.") (citations omitted).

135. Rice, *supra* note 19, at 347. *See generally* MAGARICK, *supra* note 4, § 9.04, at 9-27 to 9-28 ("[T]he original purpose of [liability] insurance [is] to see that negligently injured plaintiffs should have some responsible source of recompense. In many states the insured is forced to buy automobile insurance just so that judgment-proof insureds will give some protection to injured third parties.").

After *Cope*, Florida's position on third-party claims is unlike that of most other states. Nevertheless, the policies behind Florida's third-party insurance law do not vary greatly from the policies of the other states. Many states allow third parties to bring an action against an insurer if the insured first incurs a loss due to the insurer's bad faith and then *assigns* to the third party the right to the action against the insurer.<sup>136</sup> The only difference between Florida and other jurisdictions is that in Florida, *Thompson* and *Cope* allow a third-party judgment creditor to bring a bad faith tort suit directly against an insurer without an assignment from the insured.<sup>137</sup> The cases following *Thompson* emphasized that *Thompson* "merely allowed the judgment creditor to step into the shoes of the insured and bring an action without an assignment by the insured."<sup>138</sup> The Supreme Court of Florida allows judgment creditors to pursue an action directly against the insurer "to remove the burden of the excess judgment from the shoulders of the insured."<sup>139</sup> Thus, Florida's policy gives third parties essentially the same substantive rights and recoveries as other states, only Florida removes the additional requirement of the assignment.<sup>140</sup>

Florida occupies a progressive position in the world of third-party insurance law. But, while Florida accomplished a progressive shift for its law, the state did not change the basic duties running between insurers, insureds, and third parties.<sup>141</sup> In Florida, the duty of good faith runs only between the insurer and the insured, and the third party is still an adversarial claimant.<sup>142</sup> The rights of the parties differ in Florida only *after* an excess judgment occurs.<sup>143</sup> Florida courts, by removing the additional step of the assignment, attempt to promote enforcement of claims made against insurers based on the insurers' acts of bad faith.<sup>144</sup>

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136. *E.g.*, *Comunale v. Traders & General Ins. Co.*, 328 P.2d 198, 202 (Cal. 1958); *see* MAGARICK, *supra* note 4, § 9.02, at 9-2; *see also* Anderson & Gold, *supra* note 62, at 691-92; Rice, *supra* note 19, at 344-45; *supra* Part III.C.2.

137. *Cope*, 462 So. 2d at 460-61; *see also Thompson*, 250 So. 2d at 264; Neff, *supra* note 23, at 280-81.

138. *McLeod v. Continental Ins. Co.*, 591 So. 2d 621, 625 n.6 (Fla. 1992) (construing *Thompson* and *Cope*).

139. *Id.*

140. In the 1990s, Florida flirted with the idea of allowing a direct action by third-party claimants based on Florida's Unfair Insurance Practices Act, which was enacted in 1995. *See* *Auto-Owners Ins. Co. v. Conquest*, 658 So. 2d 928 (Fla. 1995); *see also Zebrowski v. State Farm Fire & Cas. Co.* 673 So. 2d 562 (Fla. Dist. Ct. App. 1996), *quashed and rev'd* by *State Farm Fire & Cas. Co. v. Zebrowski*, 706 So. 2d 275 (Fla. 1997); Beets, *supra* note 105, at 324-25. However, the Supreme Court of Florida eventually ruled that Florida's Unfair Insurance Practices Act merely had the effect of codifying *Thompson* and *Cope*; and thus, a third party could only file a bad faith claim against an insurer *after* winning an excess judgment against the insured in the underlying case. *State Farm Fire & Cas. Co. v. Zebrowski*, 706 So. 2d 275, 277 (Fla. 1997); *see also* Beets, *supra* note 105, at 325.

141. *See McLeod*, 591 So. 2d at 625 & n.6.; *see also Cope*, 462 So. 2d at 460-61.

142. *See McLeod*, 591 So. 2d at 625 n.6; *see also Cope*, 462 So. 2d at 460-61.

143. *See McLeod*, 591 So. 2d at 625 n.6; *see also Cope*, 462 So. 2d at 460-61; *Thompson*, 250 So. 2d at 264; MAGARICK, *supra* note 4, § 19.05, at 9-31.

144. *See McLeod*, 591 So. 2d at 625 n.6.

There is no doubt that Florida's position is very progressive, very pro-insured, and pro-third party; but this seems to be the trend in insurance law.<sup>145</sup> Since California first recognized an insurer's implied duty of good faith in *Comunale v. Traders & General Insurance Co.*,<sup>146</sup> the trend in insurance law is for courts to bestow increasingly more rights on the "little guys"—the insureds and the aggrieved third parties.<sup>147</sup> This trend, however, is not popular with all scholars in the insurance field. Many scholars maintain that there is nothing inherently unfair about an insurance contract, and awarding huge payoffs to litigants for an insurer's bad faith only raises the premiums paid by all other purchasers of insurance.<sup>148</sup> Nevertheless, the urge to interpret the relationship between insurance companies and their insureds as a David versus Goliath struggle<sup>149</sup> (with the insureds and third parties in need of extracontractual protection) has been too overwhelming for most in the judiciary to resist.<sup>150</sup> As a result, insureds and third parties in jurisdictions across the country enjoy more protection now than they ever have in the past.<sup>151</sup> Therefore, while Florida's position undoubtedly has its advantage and disadvantages, it is a position that is in tune with the current trends in insurance law. Florida's position is one that should be studied and seriously considered by other jurisdictions that want their insurance law to promote the judicial policies of protecting insureds and enforcing an insurer's duty to deal with insureds in good faith.

Now that the history of bad faith law, its peculiarities, and its divisions between jurisdictions<sup>152</sup> have been examined, Part IV will compare Indiana's bad faith law to

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145. See generally Anderson & Gold, *supra* note 62, at 691-95; Bopp, *supra* note 12, at 524; Rice, *supra* note 19, at 327-28, 340-50.

146. 328 P.2d 198, 200 (Cal. 1958).

147. See generally Bopp, *supra* note 12, at 524, 526; Rice, *supra* note 19, at 327-28, 340-50.

148. See generally MAGARICK, *supra* note 4, § 9.02, at 9-2 to § 9.05, at 9-32; Rice, *supra* note 19, at 327-28, 340-50.

149. See Bopp, *supra* note 12, at 524.

T[he Law] recognizes the relationship between policyholders and their insurance companies as "special." Viewed as no other contract is, an insurance policy is seen as bringing together a vulnerable, trusting seeker of protection and a financially hyper-fortified institution. So characterized, disputes between insurers and insureds take on a David-and-Goliath aspect: little guys hopelessly pitted against towering organizational juggernauts.

*Id.*

150. See generally MAGARICK, *supra* note 4, § 9.02, at 9-2 to § 9.05, at 9-32; Rice, *supra* note 19, at 327-28, 340-50.

151. See generally MAGARICK, *supra* note 4, § 9.02, at 9-2 to § 9.05, at 9-32; Bopp, *supra* note 12, at 524; Rice, *supra* note 19, at 327-28, 340-50.

152. See, e.g., Bopp, *supra* note 12, at 524.

Courts, recognizing the unique peculiarities of the insurance environment, now have fashioned an equally unique creation for policyholders—an implied covenant of good faith and fair dealing. The implied covenant possesses an essence of contract with the bloodlines of tort, a breed so curious that courts experience division, ambivalence and inconsistency in establishing its

the law of other jurisdictions. Then, Part V will propose suggestions for how Indiana may improve its bad faith law.

#### IV. DEVELOPMENT OF INDIANA'S BAD FAITH TORT LAW

Indiana courts, like courts in many jurisdictions, developed the state's bad faith law over time, adding and fine-tuning existing insurance law to adapt to the new bad faith doctrine.<sup>153</sup> Along the way, Indiana courts looked to other jurisdictions for guidance and, at times, adopted the reasoning of influential decisions from other courts in formulating Indiana's law.<sup>154</sup> This Part traces the development of Indiana's bad faith law and identifies certain areas of concern that remain in Indiana's law. Then, the following Part, Part V, will suggest how Indiana courts can address these areas of concern.

In *Erie Insurance Co. v. Hickman by Smith*,<sup>155</sup> the Supreme Court of Indiana first recognized an insurer's duty to deal with its insureds in good faith.<sup>156</sup> Since *Erie*, Indiana's bad faith insurance law has been in a state of flux. Courts in the state have defined and redefined the parameters of the tort since its inception in 1993.<sup>157</sup>

*Erie* held that an insurer's breach of the duty of good faith it owes to its insureds can result in a cause of action in tort,<sup>158</sup> but it declined to define the parameters of that cause of action.<sup>159</sup> Specifically, *Erie* declined to resolve whether an insured's cause

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contours. Having matured from third-party to first-party application, the covenant-based bad faith action has become an effective weapon for insureds and is now recognized by a majority of jurisdictions, some characterizing it as tort, other preferring contract or statutory expression.

*Id.*

153. *See, e.g.*, *Erie Ins. Co. v. Hickman by Smith*, 622 N.E.2d 515 (Ind. 1993); *Menefee v. Schurr*, No. 79A02-0010-CV-639, 2001 WL 727202 (Ind. Ct. App. June 27, 2001); *Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482 (Ind. Ct. App. 1998); *Dimitroff v. State Farm Mut. Auto. Ins. Co.*, 647 N.E.2d 339 (Ind. Ct. App. 1995); *Economy Fire & Fire Cas. Co. v. Collins*, 643 N.E.2d 382 (Ind. Ct. App. 1994); *Eichler v. Scott Pools, Inc.*, 513 N.E.2d 665, 667-68 (Ind. Ct. App. 1987); *Snow v. Bayne*, 449 N.E.2d 296 (Ind. Ct. App. 1983); *Bennett v. Slater*, 289 N.E.2d 144 (Ind. Ct. App. 1972); *Kingan & Co. v. Maryland Cas. Co.*, 115 N.E.348 (Ind. Ct. App. 1917).

154. *See, e.g.*, *Erie*, 622 N.E.2d at 519 n.1 (noting that a majority of jurisdictions recognize a cause of action for an insurer's breach of its duty of good faith, the Supreme Court of Indiana also adopted such a right); *Bennett*, 289 N.E.2d at 147-48 (adopting the position of the majority of jurisdictions that a third-party judgment creditor may not bring a claim against an insurer without first receiving an assignment of that claim from the insured).

155. 622 N.E.2d 515 (Ind. 1993).

156. *Id.* at 519.

157. *E.g.*, *Menefee v. Schurr*, No. 79A02-0010-CV-639, 2001 WL 727202 (Ind. Ct. App. June 27, 2001); *Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482 (Ind. Ct. App. 1998); *Dimitroff v. State Farm Mut. Auto. Ins. Co.*, 647 N.E.2d 339 (Ind. Ct. App. 1995); *Econ. Fire & Fire Cas. Co. v. Collins*, 643 N.E.2d 382 (Ind. Ct. App. 1994).

158. *Erie*, 622 N.E.2d at 519.

159. *Id.* at 519 n.2 ("Although the majority of states recognize a cause of action in tort in

of action for breach of the duty of good faith applied in the first-party or the third-party context.<sup>160</sup> Nevertheless, since *Erie*, Indiana courts now acknowledge causes of action brought by insureds for the breach of the duty of good faith in the first-party context.<sup>161</sup> Indiana courts also acknowledge causes of action brought by insureds for their insurers' failure to defend them from liability in the third-party context.<sup>162</sup> Indiana courts explicitly refuse, however, to recognize any bad faith action brought by a third party claimant directly against an insurer when the third party has not first received an assignment from the insured for the right to bring that claim.<sup>163</sup> These parts of Indiana law are well settled, unproblematic, and in agreement with principles adopted by most jurisdictions.<sup>164</sup>

However, this Note addresses two parts of Indiana law that remain problematic. The first problem is the requirement that third-party judgment creditors must receive an assignment from the tortfeasor insured (the judgment debtor) before they may bring a bad faith claim against an insurer. The Court of Appeals of Indiana entrenched the assignment requirement into Indiana law in *Bennett v. Slater*,<sup>165</sup> and the rule from *Bennett* has remained the law ever since.<sup>166</sup> This Note posits that the assignment requirement is an unnecessary requirement that allows insurers, in certain situations, to avoid bad faith judgments in excess of policy limits altogether.<sup>167</sup> Insurers can completely avoid the portion of a bad faith judgment that exceeds the insured's policy limits when the insured (1) refuses to pursue her bad faith claim on her own and (2) further refuses to assign her bad faith claim over to the third-party judgment creditor. This is a lingering problem in Indiana law—one which allows certain lucky insurers (who acted in bad faith, nonetheless) to escape liability for an excess judgment merely due to complications in the assignment process. Part V.A. addresses this problem by arguing that Indiana would benefit by replacing its assignment requirement with

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the context of third-party claims and a lesser number for first party claims . . . there is no uniform approach among individual states. Given the variety of ways in which tort claims for the failure of the insurer to exercise good faith may arise . . . it is neither necessary nor prudent for us to fully define the parameters of the tort in this opinion.”) (citations omitted).

160. *Id.*

161. *See, e.g., USA Life One Ins. Co. of Ind. v. Nuckolls*, 682 N.E.2d 534, 536, 541-42 (Ind. 1997).

162. *See, e.g., Gooch v. State Farm Mut. Auto. Ins. Co.*, 712 N.E.2d 38, 39-41 (Ind. Ct. App. 1999); *Dimitroff v. State Farm Mut. Auto. Ins. Co.*, 647 N.E.2d 339, 341 (Ind. Ct. App. 1995). *See generally* MAGARICK, *supra* note 4, § 9.01, at 9-1.

163. *E.g., Menefee v. Schurr*, No. 79A02-0010-CV-639, 2001 WL 727202, at \*1, 3-4 (Ind. Ct. App. June 27, 2001); *Dimitroff*, 647 N.E.2d at 342; *Eichler v. Scott Pools, Inc.*, 513 N.E.2d 665, 667-68 (Ind. Ct. App. 1987).

164. *See supra* Parts II, III.C.1-3.

165. 289 N.E.2d 144, 147-48 (Ind. Ct. App. 1972).

166. *See, e.g., Menefee*, 2001 WL 727202, at \*3 (citing *Bennett* in positive terms).

167. Indiana's assignment requirement is not a problem because Indiana stands alone in its application—on the contrary, Indiana stands with a vast majority of jurisdictions that require an assignment, with Florida remaining as one of the lone standouts. *See* MAGARICK, *supra* note 4, § 9.04, at 9-26; *see also* Beets, *supra* note 105, at 316. This Note argues, rather, that the assignment requirement creates problems in certain circumstances. *See infra* Part IV.A.

Florida's third-party beneficiary theory.

The second portion of Indiana law that remains problematic occurs after a judgment creditor—via an assignment from an insured—gains the right to sue an insurer for its bad faith. After the assignment, Indiana's law is unclear on what damages a judgment creditor may recover from an insurer. Indiana courts developed the law governing assignments in *Economy Fire & Casualty Co. v. Collins*<sup>168</sup> and *Allstate Insurance Co. v. Axsom*,<sup>169</sup> but certain questions remain.

In *Collins*, the Court of Appeals of Indiana allowed a judgment creditor to bring an action against an insurer because—unlike in *Bennett*—the judgment creditor first received an assignment from the insured who was damaged by an excess judgment in the underlying case.<sup>170</sup> In *Collins*, the insurer's failure to settle the underlying case exposed its insured to an excess judgment.<sup>171</sup> The court then allowed the insured (the judgment debtor) to assign its claim for the amount of the excess judgment to the third party (the judgment creditor).<sup>172</sup> The assigned claim in *Collins*, though, involved only the breach of contract action for damages in the amount of the excess judgment.<sup>173</sup>

The Court of Appeals then expanded upon *Collins* in *Axsom*. In *Axsom*, the Court of Appeals allowed a judgment creditor, after receiving an assignment from the insured, to bring an action against the insurer for pecuniary damages plus punitive damages.<sup>174</sup> The court defined pecuniary damages as the amount of the excess judgment.<sup>175</sup> The *Axsom* court did not address, however, whether a judgment creditor may pursue damages from an insurer *other than* the amount of the excess judgment plus punitive damages.<sup>176</sup> This unanswered question is the second lingering problem in Indiana's insurance law that this Note will address. Part V.B. argues that Indiana could improve its insurance doctrine by resolving this question so that judgment creditors gain the right to collect certain damages in addition to the excess judgment and punitive damages.

## V. SUGGESTED MODIFICATIONS FOR INDIANA'S BAD FAITH TORT LAW

Because state regulation of the insurance industry offers little practical assistance

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168. 643 N.E.2d 382 (Ind. Ct. App. 1994)

169. 696 N.E.2d 482 (Ind. Ct. App. 1998).

170. *See Collins*, 643 N.E.2d at 384-86.

171. *Id.* at 383-84.

172. *See id.*; *see also Axsom*, 696 N.E.2d at 484; Andrew P. Wirick & Ann Marie Waldron Piscione, *Survey of Tort Law Developments in 1994: The Good, the Bad and the Ugly*, 28 IND. L. REV. 1097, 1111 (1995).

173. *Collins*, 643 N.E.2d at 384-86; *see also Axsom*, 696 N.E.2d at 484 n.1 (construing *Collins* as a breach of contract action rather than a tort action).

174. *Axsom*, 696 N.E.2d at 486. Although the court allowed the assignment of pecuniary and punitive damages, the court expressly refused to decide "whether a tort action for an insurer's bad faith failure to settle is assignable." *Id.* at 484 n.1. Thus, the question of whether a full bad faith tort claim is assignable remains unanswered in Indiana.

175. *Id.* at 485.

176. *See id.* at 484-86.

for insurance policyholders who have been wronged by an insurance company,<sup>177</sup> private litigation becomes an important check on the egregious conduct of insurance companies<sup>178</sup>—however, private litigants in Indiana, particularly judgment creditors, currently lack certain important rights needed to hold insurers responsible for their bad faith acts.<sup>179</sup> Part IV identified two problems that lurk in Indiana's insurance law: (1) judgment creditors must obtain an assignment from an insured before suing an insurer, and (2) after that assignment, the damages that a judgment creditor may pursue are uncertain. This Part now will address these problems by providing suggestions for how Indiana courts could enhance the rights of judgment creditors.<sup>180</sup> In doing so, Part A suggests a procedural technique that would allow judgment creditors to more easily bring a bad faith claim against an insurer; this technique would allow a judgment creditor to bring the bad faith claim even when the judgment debtor is either unable or unwilling to assign the claim to the judgment creditor. Then, Part B suggests a more substantive enhancement that would augment the damages that judgment creditors may seek with a bad faith claim.

*A. Eliminate the Assignment Requirement by  
Adopting a Limited Direct Action Theory*

Indiana law currently requires a judgment creditor to receive an assignment before pursuing an extracontractual claim against a tortfeasor's insurer.<sup>181</sup> This Part argues that Indiana courts could enhance the state's bad faith doctrine by eliminating the assignment requirement, as was done in Florida. If Indiana were to eliminate its assignment requirement, judgment creditors could more easily bring bad faith claims against insurers, which would provide a means for private litigants to better hold insurers responsible for their acts of bad faith.

Oftentimes, after an excess judgment, insureds will assign their right to a bad faith claim against the insurer over to the judgment creditor simply to resolve the excess judgment debt owed to that party.<sup>182</sup> Insureds sometimes make such an assignment happily, in which case judgment creditors have no problems pursuing the bad faith claim against the insurer.<sup>183</sup> Assignments, however, are not always unproblematic.

After an excess judgment, tortfeasor insureds sometimes cannot legally assign any

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177. See *supra* notes 2-3 and accompanying text.

178. See *supra* notes 3-4 and accompanying text.

179. See *supra* Part IV.

180. The fact that judgment creditors face restrictions in pursuing an excess judgment claim against an insurer is a problem because, when an insurance company's bad faith acts expose one of its policyholders to an excess judgment, the law *should* allow *someone* to hold the insurer responsible for its inappropriate behavior. If not, the law fails to discourage insurance companies from repeating wrongful acts. Parts A and B argue that, if Indiana were to bestow more powerful rights on judgment creditors, then judgment creditors could better act as the "someone" that holds insurers responsible for their inappropriate behavior.

181. See *supra* Part IV; see also *Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482, 484-86 (Ind. Ct. App. 1998); *Bennett v. Slater*, 289 N.E.2d 144, 147-48 (Ind. Ct. App. 1972).

182. See *supra* Part IV.

183. See *supra* Part IV.

rights to a bad faith claim to the judgment creditor.<sup>184</sup> This can happen if the insurance company has inserted a “non-assignment clause” into the insurance policy.<sup>185</sup> Or, for various reasons, insureds may not wish to assign their right to the bad faith claim over to the judgment creditor.<sup>186</sup> For example, the insured’s whereabouts might be unknown.<sup>187</sup> Or, the insured might be insolvent, in which case the insured likely would never be forced to pay the excess judgment to the judgment creditor.<sup>188</sup> When such an insured will never have to pay the excess judgment, she has no incentive to assign her right to a bad faith claim to the judgment creditor in exchange for having the judgment creditor release her from the excess judgment.<sup>189</sup> In this situation, the judgment creditor is trapped. She cannot recover the excess judgment from an insolvent insured, and, without an assignment, she cannot recover from the insurance company either.<sup>190</sup>

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184. *See generally* Anderson & Gold, *supra* note 62, at 695-713.

185. When an insured must assign its rights to a third party, the door is opened for insurance companies to assert the defenses to assignments. *See id.* The insurance company may place a non-assignment clause in the contract in an attempt to rid the insured of any ability to assign its rights to a third party. *See id.* Thus, an insurance company may slow or limit the transfer of a right to a cause of action from an insured to a third party if the jurisdiction requires a formal assignment of that right. *See id.* Courts do not necessarily honor these defenses. *See id.*

186. *See* KIMBALL, *supra* note 4, at 497.

187. *See* Bennett v. Slater, 289 N.E.2d 144, 145 (Ind. Ct. App. 1972).

188. *See* KIMBALL, *supra* note 4, at 497. *See generally* Beets, *supra* note 105, at 345.

189. *See* KIMBALL, *supra* note 4, at 497; *see also* Beets, *supra* note 105, at 317 n.9, 345. After an excess judgment, the insurance company usually pays its policy limits to the third party. *See, e.g.,* TOBIAS, *supra* note 4, at 116-17 (showing an example of how this happens in a case). But, the judgment creditor holds an executory judgment over the insured for the amount of the judgment in excess of policy limits. *See supra* notes 95-96 and accompanying text. Other than satisfying this executory judgment, the insured has very little incentive to pursue any claims against the insurer. The damages an insured can collect from a potential bad faith suit against her insurer based on the excess judgment in the underlying trial will be owed to the third party to settle the judgment debt. *See* KIMBALL, *supra* note 4, at 497; *see also* TOBIAS, *supra* note 4, at 116-17; Beets, *supra* note 105, at 317 n.9; *supra* notes 68-70 and accompanying text. Therefore, insureds who owe a judgment debt usually assign their right to any bad faith claims against the insurer over to the judgment creditor as a settlement of the judgment debt. *See* Beets, *supra* note 105, at 317 n.9; *see also supra* notes 68-70 and accompanying text. This situation fails to take into account what happens when the insured is insolvent and unwilling to assign the claim to the judgment creditor, *see* KIMBALL, *supra* note 4, at 497; *see also* Beets, *supra* note 105, at 345, or when the insured’s whereabouts are unknown, *see* Bennett, 289 N.E.2d at 145. This Note argues that Indiana courts should automatically allow the rights to the bad faith claim to pass from the insured to the judgment creditor. This is the problem that the Florida courts were addressing when they stated that the purpose of allowing the judgment creditor to bring the bad faith claim against the insurer without an assignment from the insured was “to remove the burden of the excess judgment from the shoulders of the insured.” *McLeod v. Cont’l Ins. Co.*, 591 So. 2d 621, 625 n.6 (Fla. 1992).

190. *See* KIMBALL, *supra* note 4, at 497; *see also* Beets, *supra* note 105, at 317 n.9, 345.

The judgment creditor earned the right to the money in excess of the insured's policy limits, but, without an assignment, the judgment creditor is impotent to enforce that right. Moreover, the insurance company's bad faith conduct would remain unpunished.

The judgment creditor, however, is the injured party that the law should seek to protect in these situations. An insurer's wrongful acts should not go unpunished merely due to complications in the assignment process. To remedy situations where judgment creditors cannot obtain an assignment from the insured, Indiana should adopt Florida's method of allowing a judgment creditor to bring the bad faith claim directly against the insurer without an assignment.

Allowing a claimant to bring what is essentially an adverse party's right to a claim without an assignment may seem like a radical notion for traditional tort law.<sup>191</sup> But, Florida's unorthodox method provides many benefits that, if adopted, would enhance Indiana's bad faith doctrine. For example, because Florida judgment creditors may bring direct actions against insurers, there is never a reason for a judgment creditor to commence an action for the excess judgment against the insured, which could drive the insured into bankruptcy.<sup>192</sup> This provides an obvious benefit to insureds, and, in turn, third parties benefit because they do not have to go uncompensated if the insured is insolvent or unfindable.<sup>193</sup> Furthermore, judgment creditors in Florida may bring a direct action only as the result of the underlying injury to the insured—just as with a traditional assignment.<sup>194</sup> The insurer is burdened with no additional good faith duties because the only duty the insurer owes is to its insured during the underlying case.<sup>195</sup> In other words, the insurer owes no duty of good faith to the third party.<sup>196</sup> Therefore,

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191. See *MAGARICK*, *supra* note 4, § 9.04, at 9-26 (“The great majority of decisions hold that in the absence of an assignment from the insured . . . , an insurer owes no duty to a judgment creditor in the original suit who, accordingly, may not bring a direct action against the insurance company for a verdict in excess of the policy limits.”); *supra* note 167.

192. Rice, *supra* note 19, at 346.

193. See *id.* at 346-47.

194. See *Fidelity & Cas. Co. v. Cope*, 462 So. 2d 459, 461 (Fla. 1985) (“The basis for an action remain[s] the damages of an insured from the bad faith action of the insurer which caused its insured to suffer a judgment for damages above his policy limits.”).

195. See *supra* Part III.C.4; see also *McLeod v. Cont'l Ins. Co.*, 591 So. 2d 621, 625 n.6 (Fla. 1992); *Cope*, 462 So. 2d at 460-61.

196. See *supra* Part III.C.4; see also *McLeod*, 591 So. 2d at 625 n.6; *Cope*, 462 So. 2d at 460-61.

Indiana courts refuse to allow a judgment creditor to bring a direct claim against an insurer by reasoning that, because third parties are strangers to the insurance contract, insurance companies owe them no duty. *Bennett v. Slater*, 289 N.E.2d 144, 148 (Ind. Ct. App. 1972) (citing Robert F. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1176 (1954)); see also *Beets*, *supra* note 105, at 329-30. Indiana courts are correct that third parties are a stranger to the insurance contract (and insurance companies should owe no duty to third-party claimants), see *supra* Part III.C.3, but insurers' duties do not change when courts allow direct actions only after an excess judgment. See *supra* Part III.C.4; see also *McLeod*, 591 So. 2d at 625 n.6; *Cope*, 462 So. 2d at 460-61. If a state allows only a limited direct action, like Florida, the insurer's duties before the excess judgment are exactly the same

Florida bestows additional rights and protections on third parties and insureds—while an insurer’s only duty remains its duty to its insureds.<sup>197</sup>

Florida’s “third-party beneficiary” (or “limited direct action”) theory<sup>198</sup> is a safe

as in states with an assignment requirement. *See supra* Part III.C.4; *see also McLeod*, 591 So. 2d at 625 n.6; *Cope*, 462 So. 2d at 460-61. Before an excess judgment occurs, an insurer in a limited direct action state only owes a duty to handle its *insured’s* case in good faith—the third party remains an adversary during the underlying case. *See supra* Part III.C.4; *see also McLeod*, 591 So. 2d at 625 n.6; *Cope*, 462 So. 2d at 460-61. Only after an insurer’s breach of its duty of good faith results in an excess judgment for its insured may a third party step into the shoes of the insured and pursue a bad faith claim directly against the insurer. *See supra* Part III.C.4; *see also McLeod*, 591 So. 2d at 625 n.6; *Cope*, 462 So. 2d at 460-61.

Indiana courts provide further support for the assignment requirement in excess liability situations by reasoning that

[n]ot only is company without any duty to claimant to accept claimant’s reasonable settlement offer, but also, if there is a sizeable disparity between the settlement offer and the amount of the judgment obtained in the trial which follows refusal of the offer, claimant is benefited rather than harmed by company’s refusal to settle.

*Bennett*, 289 N.E.2d at 148 (quoting Robert F. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1176 (1954)). In circumstances when the insured readily assigns her rights stemming from the excess judgment to the third party, this reasoning may hold true. However, this reasoning fails to address the problems that develop when the insured is insolvent or when the insured’s whereabouts are unknown. *Beets*, *supra* note 105, at 330; *see also Bennett*, 289 N.E.2d at 145. When the judgment creditor cannot obtain an assignment from the insured, all that the judgment creditor may recover is the insured’s policy limits, which she likely demanded during settlement negotiations before the underlying suit. *See supra* Part III.A; *see also Beets*, *supra* note 105, at 329. But, rather than settling for the policy limits before trial, the insurer’s bad faith forced the insured and the third party to endure a trial. It is difficult to see how the judgment creditor is not harmed in this instance—the judgment creditor collects the same amount of money that she demanded before trial, but she had to endure a lengthy delay and a costly trial. Moreover, the third party is the *injured* party. *See Beets*, *supra* note 105, at 345. Any bad faith delay by the insurance company

may cause the third party considerable economic loss. If the third party’s injuries are severe, the third party may be unable to work and may suffer a loss of income. The loss of income, in turn may drive the third party into debt due to his inability to pay his medical bills and support his family. As a result, the third party may also suffer mental anguish.

*Beets*, *supra* note 105, at 345 (citations omitted). The Indiana courts’ reasoning that the third party “‘is benefited rather than harmed by company’s refusal to settle,’” *Bennett*, 289 N.E.2d at 148 (quoting Robert F. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1176 (1954)), makes little sense when one considers the possibility that a judgment creditor may not always be able to procure an assignment from the insured.

197. *See supra* Part III.C.4.

198. Florida, by naming its doctrine that allows a direct action by a judgment creditor against an insurer a “third-party beneficiary” theory, *see Thompson v. Commercial Union Ins. Co.*, 250 So. 2d 259, 262 (Fla. 1971), perhaps created some confusion for other courts that

way to grant a third party an action against an insurer without violating the fiduciary relationship between the insurer and the insured. Indiana should adopt Florida's limited direct action theory and eliminate the current assignment requirement to ensure that judgment creditors may litigate bad faith claims against insurers. If Indiana law were to grant these rights to judgment creditors, the law would provide a powerful means for private litigants to hold insurers responsible for their bad faith acts. Holding insurers responsible for their bad faith acts may deter them from committing future bad faith acts.<sup>199</sup>

*B. Expand Axsom to Allow Assignment of More Than an  
Excess Judgment and Punitive Damages*

Part V.A. above demonstrated how Indiana courts could enhance the state's bad faith doctrine by reforming the *procedures* that allow judgment creditors to pursue claims against insurers. Indiana courts also could enhance the state's bad faith doctrine by expanding the *substance* of the claim that judgment creditors may bring against insurers. In short, Indiana courts should allow judgment creditors to pursue claims for damages that include more than just the amount of the excess judgment plus punitive damages. Indiana courts should allow judgment creditors to seek additional damages to provide a better check on insurance companies' bad faith acts.

*Allstate Insurance Co. v. Axsom*<sup>200</sup> currently governs assignments from insureds to judgment creditors in Indiana; the opinion declared what rights an insured may assign after she is exposed to an excess judgment.<sup>201</sup> *Axsom* allows a judgment creditor to receive an assignment for the insured's right to pursue pecuniary losses plus punitive damages—which the judgment creditor may in turn pursue against the insurer.<sup>202</sup> However, the *Axsom* court defined “pecuniary damages” as the amount of the excess judgment.<sup>203</sup> Limiting assignments to the excess judgment plus punitive damages (and nothing more) presents three major problems for the judgment creditor: (1) the judgment creditor loses certain rights (that the insured would have had) due to the assignment; (2) Indiana limits the amount of punitive damages any litigant may

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faced litigants pressing for the adoption of Florida's doctrine in their jurisdiction. Other courts have refused to adopt the third-party beneficiary theory by reasoning that the third party has no privity of contract with the insurer, and thus, the third party has no right of action against the insurer. Beets, *supra* note 105, at 329-30 (discussing the Indiana and North Dakota courts' rejection of the third-party beneficiary doctrine). However, as this Note demonstrated above, Florida's third-party beneficiary theory does not require an insurer to owe a duty of good faith to a third party. See *supra* Part III.C.4; see also *McLeod*, 591 So. 2d at 625 n.6; *Cope*, 462 So. 2d at 460-61. Perhaps, therefore, Florida would be better served to call its doctrine a “limited direct action” theory rather than a “third-party beneficiary” theory. See Beets, *supra* note 105, at 324-28 (employing the term “limited direct action”).

199. See *supra* notes 1-4, 15-16 and accompanying text.

200. 696 N.E.2d 482 (Ind. Ct. App. 1998).

201. *Id.* at 484-86.

202. *Id.*

203. *Id.* at 485; see also Richard K. Shoultz, *Survey of Recent Developments in Insurance Law*, 32 IND. L. REV. 891, 897 (1999).

recover; and (3) the limited amount of recovery creates a potential for conflicts of interest between judgment creditors and their attorneys.

1. First Problem: Rights to Certain Damages  
Dissolve Via the Assignment

Following an assignment, the judgment creditor cannot bring a claim that includes all of the remedies that were available to the insured before the assignment. For example, an insured that becomes exposed to an excess judgment in Indiana may sue her insurer for all of the remedies accompanying the tort of bad faith—the full tort permits the insured to sue not only for the amount of the excess judgment and punitive damages but for consequential damages as well.<sup>204</sup> The *Axsom* court mentions damages such as mental distress, pain and suffering, embarrassment, mental anguish, and humiliation as possible consequential damages that may result from an insurer's bad faith.<sup>205</sup> Notably, all of the consequential damages mentioned in *Axsom* are damages "personally suffered by the insured."<sup>206</sup> A judgment creditor, however, may not pursue these consequential damages because torts for personal injuries are nonassignable.<sup>207</sup>

While it makes sense that a judgment creditor should not be permitted to pursue someone else's personal tort claims,<sup>208</sup> limiting the judgment creditor's rights against the insurer to only the amount of the excess judgment plus punitive damages excludes other possible consequential damages that are *not* personal in nature—such as loss of revenues,<sup>209</sup> loss of profits,<sup>210</sup> loss of business opportunities,<sup>211</sup> interest on the judgment,<sup>212</sup> impairment of insured's credit,<sup>213</sup> clouding of title of insured's estate,<sup>214</sup> and impairment of insured's ability to apply for loans.<sup>215</sup> Because *Axsom* limited

204. See *Axsom*, 696 N.E.2d at 485; see also MCCARTHY, *supra* note 72, at 452, 455-56, 469-70.

205. *Axsom*, 696 N.E.2d at 485 (quoting *Clearwater v. State Farm Mut. Auto. Ins.*, 780 P.2d 423, 427 (Ariz. Ct. App. 1989)).

206. *Id.* Torts of a personal nature also include the torts of slander, assault, and negligent personal injuries. MCCARTHY, *supra* note 72, at 456.

207. *Axsom*, 696 N.E.2d at 485.

208. *Id.* ("[F]ew legal principles are as well settled . . . as the rule that the common law does not permit assignment of causes of action to recover for personal injuries.") (quoting *Picadilly, Inc. v. Raikos*, 582 N.E.2d 338, 340 (Ind. 1991)); see *supra* Part III.C.2.

209. *Birth Ctr. v. St. Paul Companies, Inc.*, 727 A.2d 1144, 1157 (Pa. Super. Ct. 1999).

210. *Id.*

211. *Id.*

212. MCCARTHY, *supra* note 72, at 472.

213. *Axsom*, 696 N.E.2d at 485 (citing *Econ. Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 385 (Ind. Ct. App. 1994)). The *Collins* decision first categorized impairing the insured's credit, clouding the title of an insured's exempt estate, and impairing the insured's ability to apply for loans as "actual damages." *Collins*, 643 N.E.2d at 385.

214. *Axsom*, 696 N.E.2d at 485.

215. *Id.*

assignments to the amount of the excess judgment plus punitive damages,<sup>216</sup> Indiana judgment creditors acquire the right to pursue fewer consequential damages—including fewer consequential damages for injury to *property*—than the insured originally held. This is a peculiar result given the logic that *Axsom* applied to allow the assignment of excess judgments.

The *Axsom* court characterized excess judgments as injury to the insured's property, and thus permitted their assignment.<sup>217</sup> However, some consequential damages also represent injury to the insured's property.<sup>218</sup> The *Axsom* decision did not determine whether these consequential damages to the insured's property would be assignable along with the excess judgment.<sup>219</sup> This is an area where Indiana courts could fortify the rights of judgment creditors without even modifying the existing law. Indiana courts could categorize certain consequential damages resulting from an insurer's bad faith as damages to the insured's property, and then declare these damages assignable under the existing rules of *Axsom*.

Furthermore, the *Axsom* court's logic for permitting the assignment of punitive damages provides additional support for permitting the assignment of consequential damages to property. Punitive damages result from wrongs done personally to a policyholder.<sup>220</sup> *Axsom* permitted the assignment of punitive damages, however, because they are not intended to compensate personal injury.<sup>221</sup> Similarly, consequential damages result when an insurer wrongs a policyholder, but consequential damages to property also do not compensate personal injury.<sup>222</sup> They compensate injury to property.<sup>223</sup> Therefore, following the reasoning of *Axsom*, they should be assignable.

One might argue that allowing a judgment creditor to pursue a claim for the consequential damages to the insured's property would force the judgment creditor into the awkward position of arguing for someone else's consequential damages at trial. An attorney's argument that her client deserves money because the defendant's wrongful settlement practices caused someone else (who may not even appear in the courtroom) to lose profits seems odd. Viewed this way, consequential damages to the insured's property seem rather personal. However, this argument is no more odd than the attorney's argument that her client deserves punitive damages due to the egregious manner that the defendant treated someone else. The law of assignments simply forces

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216. *Id.*

217. *Id.*

218. *See supra* notes 208-14 and accompanying text.

219. *See Axsom*, 696 N.E.2d at 485 (citing *Econ. Fire & Cas. Co. v. Collins*, 643 N.E.2d 382, 385 (Ind. Ct. App. 1994)).

220. MCCARTHY, *supra* note 72, at 456 (“[P]unitive damages usually are allowed to the insured in excess liability cases only when the insured has suffered a serious injury to his or her person (such as, typically, mental distress resulting from apprehension of financial disaster). . .”).

221. *Axsom*, 696 N.E.2d at 485-86; *see also* MCCARTHY, *supra* note 72, at 517 (“[P]unishment and deterrence . . . [are] the universally recognized rationale[s] for the allowance of punitive damages.”).

222. *See supra* notes 208-14 and accompanying text.

223. *See supra* notes 208-14 and accompanying text.

assignees to further a fundamentally odd argument.

Indiana courts, however, do not focus on the arguments that litigants must make after an assignment when determining whether a claim is assignable.<sup>224</sup> Indiana courts only focus on the types of damages sought by assignees.<sup>225</sup> As long as assignees have pursued damages other than damages for personal injuries, Indiana courts have allowed the assignees to bring their claims.<sup>226</sup> Excess judgment claims pursue pecuniary losses; thus Indiana courts allow their assignment.<sup>227</sup> Punitive damages claims pursue losses designed to punish and deter rather than to compensate personal injury; thus Indiana courts permit their assignment.<sup>228</sup> Consequential damages claims based on emotional harm pursue losses for personal injuries; thus Indiana courts prohibit their assignment.<sup>229</sup> Consequential damages claims based on monetary loss caused by an insurer's bad faith pursue losses to property rather than losses for personal injuries,<sup>230</sup> and thus, Indiana courts *should* permit their assignment. Furthermore, allowing assignments of consequential damages for injury to property would follow the established guidelines of *Axson* and promote Indiana's policy that "the types of tort claims which may not be assigned have become so narrow that nonassignability of tort actions is now the exception while assignability is the general rule."<sup>231</sup>

If, through an assignment, "the assignee acquires no more rights than were possessed by the assignor,"<sup>232</sup> why must the assignee lose rights—including rights to pursue damages for injury to property—that the insured could have pursued? This presents a problem because the judgment creditor is the party that will most likely pursue the bad faith claim against the insurer.<sup>233</sup> If judgment creditors lose potential damages claims through assignments, then judgment creditors cannot hold insurance companies accountable for the entirety of their bad faith acts. If insurers know that the full consequences of their acts of bad faith may never be recoverable by judgment creditors, then they have less reason to avoid committing those bad faith acts in the first place (against insureds). Bad faith actions sometimes serve as effective deterrents against wrongful claims handling practices by insurance companies.<sup>234</sup> But, bad faith causes of action lose teeth if rights vanish during the transfer to the party that most likely will assume the eventual role of plaintiff against the insurer.

To summarize the theory postulated in this Part: Indiana courts should allow assignment of the excess judgment, all consequential damages for injury to property,<sup>235</sup> and all punitive damages. The only nonassignable claims would then be

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224. *See Axson*, 696 N.E.2d at 484-86.

225. *Id.*

226. *Id.*

227. *Id.* at 485.

228. *Id.* at 485-86.

229. *Id.* at 485.

230. *See supra* notes 208-14 and accompanying text.

231. *Axson*, 696 N.E.2d at 485.

232. *Seamands, supra* note 77, at 265.

233. *See supra* Part III.C.2.

234. *See supra* note 4.

235. The bad faith tort doctrine most commonly applies in automobile accident cases. *See*

tort claims for personal injuries.<sup>236</sup> Furthermore, to incorporate the limited direct action theory from Part V.A., the judgment creditor no longer needs an assignment before initiating an action against the insurer. The judgment creditor simply steps into the shoes of the insured<sup>237</sup> and may pursue all of the insured's possible claims, with the exception of tort claims for personal injuries. This theory automatically releases the insured from any liability from the excess judgment.<sup>238</sup> The tort claim that results from the excess judgment simply accrues to the judgment creditor—the actual injured party—rather than the insured.<sup>239</sup> The result will be enhanced rights for judgment

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Bopp, *supra* note 12, at 525. With an automobile accident, the insured will likely incur consequential damages of a personal nature, such as emotional distress, pain and suffering, or mental distress over the financial problems resulting from the accident. *See Axsom*, 696 N.E.2d at 485; *see also* MCCARTHY, *supra* note 72, at 456. But in some liability insurance situations, consequential damages to property can be very substantial. For example, in *Birth Ctr. v. St. Paul Companies, Inc.*, 727 A.2d 1144 (Pa. Super. Ct. 1999), the insurer represented a hospital that was sued by a third party that brought a medical malpractice claim based on the events surrounding the birth of their daughter. *Id.* at 1149. Before the trial of the underlying case, the third party made repeated attempts to settle within the insured's policy limits. *Id.* at 1150-51. The insurer refused all such attempts at settlement. *Id.* The case proceeded to trial and the jury returned a verdict \$3,317,743.34 in excess of the insured's policy limits. *Id.* at 1151.

After the excess judgment, the insured initiated a bad faith suit against the insurer. *Id.* The insurer paid the amount of the excess judgment, *id.*, and then claimed that this precluded the insured from pursuing any claims for other consequential damages, *id.* at 1157. The court disagreed, and allowed the insured to pursue a claim for consequential damages based on lost revenues, lost profits, and "lost business opportunities in the form of a lost mortgage for expansion of its facility." *Id.* The court upheld the jury's verdict of \$700,000 for the consequential damages alone. *Id.*

Under the theory suggested in Part V.B.1. of this Note, the insured in *Birth Center* could have assigned its claim over to the third party, because the insured's consequential damages resulted from injury to its property. Furthermore, the theory suggested in Part V.A. would allow the judgment creditor to bring the claim without an assignment.

236. The insured need not necessarily lose her entire claim after she executes an assignment. One California case demonstrated that "when an insured elects to assign the cause of action for the excess judgment to the injured party, the insured may nonetheless reserve any cause of action that he or she might bring for emotional distress as a result of the insurer's failure to settle within policy limits." MCCARTHY, *supra* note 72, at 456-57 (citing *Cain v. State Farm Mut. Auto. Ins. Co.*, 47 Cal. App. 3d 783 (1975)). The insured accomplishes this by giving a partial assignment to the judgment creditor and then joining the judgment creditor as parties plaintiff in a single suit against the insurer. *Id.* at 457.

237. *See supra* Part III.C.4.

238. *See supra* Part III.C.4. Additionally, this "automatic assignment" fulfills the reasonable expectations of the insured. *See Rice*, *supra* note 19, at 344-45. The insured expects her insurance policy to pay for *any* liability she incurs to third parties. *Id.* The insured does not expect to be exposed to an excess judgment, especially since it bought liability insurance specifically to prevent such a thing. *Id.*

239. Even with the "automatic assignment," the insured need not lose all of her claim against the insurer. Indiana could write its "automatic assignment" doctrine so that, if the

creditors. These enhanced rights will additionally provide a check on bad faith activities by insurers.

## 2. Second Problem: Indiana Limits Punitive Damages Awards

Indiana's method of limiting assignments to the amount of the excess judgment plus punitive damages presents another problem: it severely limits the total dollar amount that a judgment creditor may recover from an insurance company because Indiana places a cap on the amount of punitive damages recoverable in any action.<sup>240</sup> Indiana caps punitive damages at the greater of three times the compensatory damages award or \$50,000.<sup>241</sup> The compensatory damages available to a judgment creditor under current Indiana law consist only of the amount of the excess judgment.<sup>242</sup> The previous subpart presented a theory to address this very problem—Indiana courts should include consequential damages (to the insured's property) as part of the compensatory damages available to the judgment creditor. That theory allows judgment creditors to increase the amount of compensatory damages that they may pursue against insurers so that, when tripled, the amount of punitive damages also may be greater.<sup>243</sup>

In 1995, Indiana enacted its version of a tort reform act.<sup>244</sup> The purpose of the Act was to limit punitive damages, which the Indiana legislature viewed as excessive.<sup>245</sup> The Act not only limited the total dollar amount of any judgment that a plaintiff could recover,<sup>246</sup> it also limited the total dollar amount that a plaintiff could actually keep from that judgment.<sup>247</sup> Believing that plaintiffs received a windfall from punitive

insured wishes, she may join the judgment creditor in the suit against the insurer to pursue any claims for consequential damages based on the insured's personal injuries. *See supra* note 236.

240. *See* IND. CODE §§ 34-51-3-1 to -6 (1998); *see also* Charles F.G. Parkinson, Note, *A Shift in the Windfall: An Analysis of Indiana's Punitive Damages Allocation Statute and The Recovery of Attorney's Fees Under the Particular Services Clause*, 32 VAL. U. L. REV. 923, 926 (1998).

241. IND. CODE § 34-51-3-4 (1998); *see also* Parkinson, *supra* note 240, at 926.

242. *See supra* Part V.B.2; *see also* *Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482, 485 (Ind. Ct. App. 1998).

243. *See supra* Part V.B.1.

244. *See* Parkinson, *supra* note 240, at 926, 951-55 (describing House Enrolled Act 1741, specifically IND. CODE §§ 34-51-3-1 to -6 (1998)).

245. *See id.* at 951; *see also* Paltrow, *supra* note 2, at A1 ("The [Indiana] insurance industry spearheaded passage in 1995 of one of the toughest tort-reform laws in the nation, sharply limiting punitive-damage awards and discouraging product-liability and negligence lawsuits.").

246. The Act provides:

A punitive damage award may not be more than the greater of:

(1) three (3) times the amount of compensatory damages awarded in the action;

or

(2) fifty thousand dollars (\$50,000).

IND. CODE § 34-51-3-4 (1998).

247. The Act provides:

damages awards, the Indiana legislature modified the punitive damages law by requiring that seventy-five percent of any punitive damage award be paid to the state.<sup>248</sup> The plaintiff could only receive the remaining twenty-five percent.<sup>249</sup> In 2002 the Indiana Court of Appeals nullified the section of the Act that required the seventy-five percent/twenty-five percent split payout,<sup>250</sup> but the total dollar amount cap remains intact.

Upon the enactment of this statute, a problem arose for trial lawyers who litigate bad faith claims against insurance companies. Because the statute caps punitive damages in proportion to compensatory damages, the statute forced trial attorneys to try to think of new tactics that would inflate the amount of compensatory damages in the bad faith claim against the insurer so that, when multiplied by three, the cap on the punitive damages may also be higher.<sup>251</sup> Under current Indiana law, however, attorneys representing judgment creditors may only pursue a fixed amount of compensatory damages—*Axsom* set the amount of compensatory damages at the amount of the excess judgment.<sup>252</sup> Thus, the statute affects judgment creditors in an especially harsh manner.

This situation presents a fundamental unfairness for judgment creditors. The purpose of punitive damages is to punish egregious acts and to prevent such acts from recurring.<sup>253</sup> In the third-party bad faith setting, the law should punish wrongdoing insurers at a rate proportionate to the total amount of damage they cause. Insurers incur their actual liability for punitive damages by dealing with their *insureds* in bad faith. Any damages from an insurer's bad faith acts initially accrue to the insured, not

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(a) . . . [W]hen a judgment that includes a punitive damage award is entered in a civil action, the party against whom the judgment was entered shall pay the punitive damage award to the clerk of the court where the action is pending.

(b) Upon receiving the payment described in subpart (a), the clerk of the court shall:

(1) pay the person to whom punitive damages were awarded twenty-five percent (25%) of the punitive damage award; and

(2) pay the remaining seventy-five percent (75%) of the punitive damage award to the treasurer of state, who shall deposit the funds into the violent crime victims compensation fund

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IND. CODE § 34-51-3-6 (1998) (ruled unconstitutional by *Cheatham v. Pohle*, 764 N.E.2d 272 (Ind. Ct. App. 2002)).

248. *Id.*

249. *Id.*

250. *See Cheatham*, 764 N.E.2d 272; *see also infra* Part V.B.3.

251. *See Parkinson*, *supra* note 240, at 965-66.

252. *See supra* Part V.B.1.; *see also Axsom*, 696 N.E.2d at 485. Using the figures from the *Axsom* case as an example, the plaintiff received a judgment of \$80,500, or \$30,500 above the insured's \$50,000 policy limits. *Axsom*, 696 N.E.2d at 484. Indiana's punitive damages limiting statute interprets the plaintiff's compensatory damages as the \$30,500. IND. CODE § 34-51-3-4 (1998); *see also Axsom*, 696 N.E.2d at 484. Therefore, the limiting statute caps the plaintiff's potential punitive damages award at \$91,500. IND. CODE § 34-51-3-4 (1998); *see also Axsom*, 696 N.E.2d at 484.

253. *See Parkinson*, *supra* note 240, at 930.

to the third party.<sup>254</sup> With Indiana's limiting statute, litigants cannot punish insurers at a rate based on a percentage of their total wealth.<sup>255</sup> So, wrongdoing insurers should at least be punished at a rate proportionate to the *total* amount of damage they cause—that is, the amount they initially cause for the insured. However, because judgment creditors pursue excess liability claims more frequently than insureds,<sup>256</sup> the punitive damages levied on insurers likely will not be determined as a proportion of the insured's compensatory damages. Rather, punitive damages will be determined as a proportion of the compensatory damages that a judgment creditor may bring after an assignment. Compensatory damages drop to the mere amount of the excess judgment upon assignment from an insured to a judgment creditor under current Indiana law.<sup>257</sup> The assignee, therefore, starts with a lower amount of compensatory damages—lower compensatory damages in turn signify that the assignee will face a lower cap on her potential punitive damages award.<sup>258</sup>

Why should the law punish wrongdoing insurers less severely after an assignment than it could have before the assignment occurred? The assignment certainly makes the insurers' wrongful acts no less egregious. Given that judgment creditors pursue the eventual bad faith claims more regularly than insureds, current Indiana law often cannot punish insurance companies for the *total* amount of damages they inflict. This is the crux of the fairness problem—insurers can commit egregious acts without receiving the full punishment for those acts.

Indiana could remedy this problem by eliminating the cap on punitive damages and punishing wrongdoing insurance companies based on a percentage of their total wealth. Because it is highly unlikely that Indiana will eliminate its punitive damages cap anytime in the near future, this Note presented a theory in Parts V.A. (limited direct action theory) and V.B.1. (increased compensatory damages) that allows judgment creditors to pursue a greater percentage of the damages that the insurer actually inflicted upon the insured. This theory allows a larger amount of compensatory damages to pass from the insured to the judgment creditor by way of (automatic) assignment, which in turn allows the judgment creditor to pursue a greater amount of punitive damages. Giving judgment creditors these enhanced rights to pursue higher damages awards would provide an effective check on egregious conduct by insurers.

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254. See *Axson*, 696 N.E. 2d at 485; see also MCCARTHY, *supra* note 72, at 456.

255. See SHERNOFF, *supra* note 2, at 16. When statutes do not limit punitive damages awards, the law often sets the amount of punitive damages based on the defendant's wealth. *Id.* In a jurisdiction that utilizes no limiting statute, the following passage holds true:

The purpose of punitive damages is to punish and make examples out of companies that engage in outrageous behavior. A jury sets the amount of punitive damages based on the amount of money it will take to make an errant company change and start behaving more responsibly. The larger the company, the larger the amount of punitive damages.

*Id.*

256. See *supra* Part III.C.2.

257. See *supra* Part V.B.1; see also *Axson*, 696 N.E.2d at 485.

258. IND. CODE § 34-51-3-4 (1998).

### 3. Third Problem: Conflicts of Interest Arise Between Judgment Creditors and Their Attorneys

Indiana's method of limiting assignments to the amount of the excess judgment plus punitive damages also presents a potentially unethical incentive for the judgment creditor's attorney handling the case.<sup>259</sup> After an assignment, Indiana's punitive damages limiting statute—as it was enacted in 1995—mandated that a judgment creditor could only claim twenty-five percent of any punitive damages award recovered from a wrongdoing insurer.<sup>260</sup> The statute did not address, however, whether the judgment creditor's attorney could claim part of her fee from the state's share of the total award.<sup>261</sup> In other words, the statute did not address whether the attorney working on contingency could take her fee as a percentage of the total judgment, or only as a percentage of the plaintiff's twenty-five percent share of the judgment.<sup>262</sup> Due to these ambiguities, the Indiana Court of Appeals declared Indiana Code Section 34-51-3-6 (which mandated the seventy-five percent/twenty-five percent split payout, but which did “not define from which portion an attorney's fees may be taken”)<sup>263</sup> unconstitutional in 2002.<sup>264</sup>

However, the Indiana Court of Appeals left room for the Indiana Legislature to resurrect the statute in a slightly modified form. The court held that “since the statute does not require the state to compensate the attorney for the prevailing party, it requires attorneys who win a punitive damage award to perform particular services without just compensation on demand from the State.”<sup>265</sup> The court further ruled the statute “void on its face as a matter of law to the extent that it requires attorneys to perform, upon demand from the State, particular services without just compensation.”<sup>266</sup> Additionally, the court explicitly ruled that requiring the winning client to turn over seventy-five percent of her punitive damages to the State was *not*

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259. See Parkinson, *supra* note 240, at 955-56, 965-66.

260. IND. CODE § 34-51-3-6 (1998) (ruled unconstitutional by *Cheatham v. Pohle*, 764 N.E.2d 272 (Ind. Ct. App. 2002)); see also *supra* Part V.B.2.

261. Parkinson, *supra* note 240, at 955-56.

262. *Id.* Returning to the figures of the *Axson* case as an example, see *supra* note 252, Indiana's limiting statute caps the plaintiff's potential punitive damages award at \$91,500. IND. CODE § 34-51-3-4 (1998); see also *Axson*, 696 N.E.2d at 484. Then, under the former Indiana Code Section 34-51-3-6, the plaintiff could keep only twenty-five percent of that award, or \$22,875. IND. CODE § 34-51-3-6 (1998) (ruled unconstitutional by *Cheatham*, 764 N.E.2d 272); see also *Axson*, 696 N.E.2d at 484. If the attorney then took a hypothetical thirty-three percent fee, that potential fee would range from \$29,865.00 to \$7,548.75, depending on whether the attorney took her fee as a percentage of the total judgment or as a percentage of the plaintiff's twenty-five percent take of the judgment. IND. CODE § 34-51-3-6 (1998) (ruled unconstitutional by *Cheatham*, 764 N.E.2d 272); see also *Axson*, 696 N.E.2d at 484; Parkinson, *supra* note 240, at 955-56.

263. *Cheatham*, 764 N.E.2d at 281 n.8.

264. *Id.* at 281.

265. *Id.*

266. *Id.*

an illegal taking.<sup>267</sup>

This holding leads one to believe that the statute could be re-enacted if it were to contain a provision that required the State to pay a percentage of the winning attorney's fee (with her client paying the remainder). This way, the attorney would receive compensation for the entirety of her services and the statute—according to the reasoning of the Indiana Court of Appeals—would no longer offend the Indiana Constitution.<sup>268</sup> However, if the Legislature were to resurrect the statute so that the winning attorney could take her fee from the total judgment (the compensatory damages plus 100 percent of the punitive damages) but the winning client could only receive compensatory damages plus twenty-five percent of the punitive damages, a conflict of interests would arise between the attorney and her client.

If, under a resurrected form of the statute, the judgment creditor's attorney could take her contingency fee from the total potential judgment (funded in part by the State and in part by her client), then the statute would give incentives for attorneys to pursue potentially large punitive damages awards at trial.<sup>269</sup> A large punitive damages award at trial would grant an attorney working on contingency a handsome fee. This statute would provide further incentives for the attorney to proceed to trial because, if the client elects to settle for the amount of the excess judgment, the attorney will receive her fee only from the settlement money.<sup>270</sup> Given that the attorney realizes that a trial could produce a verdict of the amount of the excess judgment (the compensatory damages) and punitive damages of three times the excess judgment (for a total of four times the compensatory damages),<sup>271</sup> the attorney will wish to continue to trial in hopes of collecting her fee as a percentage of the total judgment.<sup>272</sup> The client's best interests, however, may not suggest proceeding to trial.

The client will realize that the resurrected statute would limit her potential recovery to the compensatory damages plus a mere twenty-five percent of any punitive damages award.<sup>273</sup> The insurer would likely readily offer to settle for the amount of the excess judgment to avoid the punitive damages issue at trial.<sup>274</sup> The client will see the offer ("a bird in the hand") and will see that, even if her attorney were to win the full amount of punitive damages, her total take home amount would not even double with a trial.<sup>275</sup> Thus, the client would likely wish to settle.<sup>276</sup>

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267. *Id.* at 276-77.

268. *Id.* at 277-81.

269. *See* Parkinson, *supra* note 240, at 965-66.

270. *See id.*

271. IND. CODE § 34-51-3-6 (1998) (ruled unconstitutional by *Cheatham*, 764 N.E.2d 272).

272. The attorney may also harbor emotional reasons for wishing to pursue the punitive damages claim against the insurer at trial, such as a disdain for insurance companies (a trait that is not uncommon among plaintiffs' trial attorneys). *See, e.g.*, SHERNOFF, *supra* note 2, at 17; TOBIAS, *supra* note 4, at 102.

273. IND. CODE § 34-51-3-6 (1998) (ruled unconstitutional by *Cheatham*, 764 N.E.2d 272).

274. *See* Parkinson, *supra* note 240, at 965-66.

275. Using the figures from *Axson* again as examples, *see supra* note 252, the client received the rights to pursue a claim for \$30,500 in compensatory damages (the amount of the

Therefore, Indiana's punitive damages limiting statute—if resurrected—could exacerbate the problems caused by Indiana's method of limiting assignments to the amount of the excess judgment plus punitive damages. Attorneys must protect the best interests of their injured clients. However, their thoughts might be clouded by visions of huge punitive damages awards. The very best thing that Indiana courts could do to eliminate a conflict of interests between attorneys and their clients is to rule that Indiana Code Section 34-51-3-6 is completely void, so that attorneys and their clients share their winnings as a percentage of the same judgment amount.

However, if the statute were resurrected so that attorneys could receive their fees as a percentage of the total punitive damages while their clients could only receive twenty-five percent of the punitive damages, the theory posited in Parts V.A. and V.B.1. of this Note presents a method for alleviating the problems caused by this conflict of interests. Perhaps, if the law were to allow judgment creditors to receive the rights to greater compensatory damages from insureds, then judgment creditors would experience greater incentives to pursue the correspondingly greater punitive damages awards. More likely, though, this theory would help the judgment creditor settle for a sum slightly larger than the mere amount of the excess judgment. The presence of the extra compensatory damages provides the judgment creditor more leverage during settlement proceedings with the insurance company. In either a trial or a settlement proceeding, the enhanced rights enjoyed by the judgment creditor present a greater likelihood that the judgment creditor will succeed at holding the insurer accountable for its wrongful acts through a private cause of action.

This Part presented a theory designed to improve Indiana's bad faith law. The first part of the theory would allow judgment creditors to enforce claims against insurers more easily.<sup>277</sup> The second part would then enhance the amount of damages that judgment creditors could collect from insurers.<sup>278</sup> Both theories were forwarded under the same premise and designed to achieve the same end: enhanced rights for

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excess judgment) plus punitive damages. *Allstate Ins. Co. v. Axsom*, 696 N.E.2d 482, 484 (Ind. Ct. App. 1998). Indiana's punitive damages limiting statute caps the punitive damages award that the client could receive at three times the amount of compensatory damages (or \$91,500), of which the client would only collect twenty-five percent (or \$22,875). IND. CODE §§ 34-51-3-4, -6 (1998) (Section 6 ruled unconstitutional by *Cheatham*, 764 N.E.2d 272); *see also Axsom*, 696 N.E.2d at 484. Therefore, if the insurance company offered to settle for the amount of the excess judgment, the client could immediately take \$30,500. *Axsom*, 696 N.E.2d at 484. The client would see that, even if her trial were to result in a large punitive damages award, the most she could collect would be \$53,375—not even double the amount of the settlement offer. IND. CODE §§ 34-51-3-4, -6 (1998) (Section 6 ruled unconstitutional by *Cheatham*, 764 N.E.2d 272); *see also Axsom*, 696 N.E.2d at 484. Seeing this, the client would likely choose to settle rather than endure the time and emotional expense of a trial.

276. The client may hold some emotional reasons of her own to settle. The client who receives an assignment of an excess judgment just ended a grueling trial in the underlying suit. The client likely will not wish to repeat that process. The client also commonly would have bills to pay from the expenses that accumulated from the time of the accident until the court entered judgment on the underlying suit.

277. *See supra* Part V.A.

278. *See supra* Part V.B.

civil litigants provide incentives for insurers to deal with their policyholders in good faith. If Indiana were to adopt these two theories, civil litigants in the state would enjoy litigation rights with stronger teeth, and insurers operating in the state would face stronger incentives to deal with their policyholders in good faith.

#### VI. CONCLUSION

For insurance policyholders, often the most meaningful avenue for seeking redress from the wrongful acts of a powerful insurance company is through civil litigation. The most effective way that a state may regulate insurance companies operating within its borders is to enhance the rights that private litigants may enforce against insurers.<sup>279</sup> Therefore, the rights that private litigants possess against insurance companies assume paramount importance in a state's insurance law policies.

In Indiana, the law currently limits private litigants' rights by restricting the compensatory and punitive damages recoverable by a judgment creditor after an assignment. This Note presents a two-part theory that enhances the rights that judgment creditors hold against insurers in Indiana. This theory allows judgment creditors more easily to pursue bad faith claims against insurers, while also enhancing the damages retrievable through such claims. Bestowing these rights upon judgment creditors would help check egregious conduct by insurance companies operating in Indiana. Insurance companies react to large losses incurred from bad faith suits, and adjust their claims-handling practices accordingly.<sup>280</sup> Enhancing the rights of private litigants ensures that Indiana insurers will treat their policyholders more fairly.

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279. *See supra* notes 1-4 and accompanying text.

280. *See supra* note 4.