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Developments in West Virginia's Insurance Bad Faith Law--Where Do We Go from Here

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DEVELOPMENTS IN WEST VIRGINIA'S INSURANCE BAD FAITH LAW — WHERE DO WE GO FROM HERE?

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I.	INTRODUCTION	268
II.	OVERVIEW OF FIRST-PARTY AND THIRD-PARTY INSUR- ANCE	269
III.	DEVELOPMENTS IN WEST VIRGINIA'S LAW OF INSURANCE BAD FAITH BETWEEN 1974 AND 1995	270
	A. <i>Statutory Bad Faith</i>	271
	1. The West Virginia Unfair Trade Practic- es Act	271
	2. <i>Jenkins v. J.C. Penney Casualty Insur- ance Co.</i>	273
	3. Interpretation of the UTPA in Other Jurisdictions	274
	4. Practical Ramifications of <i>Jenkins</i> and Its Progeny	276
	5. The Need for Clarification	280
	B. <i>Third-Party Common Law Bad Faith</i>	282
	1. <i>Shamblin v. Nationwide Mutual Insur- ance Co.</i>	284
	2. Practical Ramifications of <i>Shamblin</i>	286

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C.	<i>First-Party Common Law Bad Faith: Hayseeds, Inc. v. State Farm Fire & Casualty Co.</i>	288
D.	<i>Hybrid Cases Involving Third-Party and/or First-Party Common Law Bad Faith</i>	290
IV.	EFFORTS TO EXTEND WEST VIRGINIA'S LAW OF INSURANCE BAD FAITH	292
A.	<i>West Virginia Caselaw Concerning the Scope of the Common Law Duty of Liability Insurers</i>	293
B.	<i>Decisions in Other Jurisdictions Concerning the Extension of the Common Law Duty for the Benefit of Third-Party Claimants</i>	294
C.	<i>Impact of Extending Shamblin to Third-Party Claimants Upon the Goals of West Virginia's Bad Faith Jurisprudence</i>	296
1.	Such Extension Would Compromise the Duty Owed to Policyholders	297
2.	Such Extension Would Undermine the Cause of Action for Statutory Bad Faith	299
V.	CONCLUSION	300

I. INTRODUCTION

Between the years 1974 and 1995, dramatic changes occurred in West Virginia's law relating to "bad faith" insurance practices.¹ During this period, the Supreme Court of Appeals of West Virginia addressed not only questions that had long remained unsettled, but also newly emerging areas of insurance bad faith law. In late 1994, the court suggested, in dicta, that it might consider a further expansion of West Virginia law by creating a common law duty of good faith and

1. The use of the term "bad faith" to describe West Virginia's law regarding insurance settlement practices is something of a misnomer. As discussed more fully below, the Supreme Court of Appeals of West Virginia has expressly rejected the concept of "bad faith" as a substantive standard in key decisions concerning West Virginia's common law. The term nevertheless continues to be widely used in West Virginia and elsewhere as a shorthand designation encompassing the various rules governing insurer settlement conduct. For convenience, this Article will employ the term "bad faith" in this general sense, but will use more specific terms when discussing the actual content of the law in this area.

fair dealing running from a liability insurer to a third party suing the insurer's policyholder.²

At a time when the future of West Virginia's bad faith law is under consideration, it is appropriate to take stock of the practical ramifications of the groundbreaking decisions during the last twenty years. Accordingly, this Article will examine some of these ramifications and discuss the need for clarification of certain issues in light of recent developments. In addition, this Article will analyze the basis for creating a common law duty running from insurers to third-party claimants and assess whether creating such a duty would be consistent with the goals that the Supreme Court of Appeals of West Virginia has pursued over the last twenty years.

II. OVERVIEW OF FIRST-PARTY AND THIRD-PARTY INSURANCE

The fundamental distinction between first-party and third-party insurance is well-recognized under West Virginia law.³ First-party insurance arises where an insurer contracts to reimburse an insured up to the limits of the policy for damages suffered by the insured.⁴ Fire insurance and automobile collision policies are among the most common types of first-party insurance that the West Virginia courts have addressed.

In contrast, third-party insurance — or liability insurance — does not provide for reimbursement of the insured's own damages. Rather, the insurer pays covered claims brought against the insured by a third-party claimant.⁵ Such third-party protection typically is provided by commercial general liability insurance policies or automobile liability policies. These liability policies extend two primary benefits to the insured. First, the insurer undertakes to indemnify the insured for judg-

2. *Charles v. State Farm Mut. Auto. Ins. Co.*, 452 S.E.2d 384, 389 (W. Va. 1994).

3. *See, e.g., Weese v. Nationwide Ins. Co.*, 879 F.2d 115, 120 (4th Cir. 1989) (applying West Virginia law); *Marshall v. Saseen*, 450 S.E.2d 791, 797 (W. Va. 1994); *Lee v. Saliga*, 373 S.E.2d 345, 348 (W. Va. 1988). *See generally* DENNIS J. WALL, LITIGATION AND PREVENTION OF INSURER BAD FAITH §§ 3.01, 9.01 (2d ed. 1994) (discussing the distinction between first-party and third-party insurance).

4. *See Marshall*, 450 S.E.2d at 797; *Lee*, 373 S.E.2d at 348.

5. *Weese*, 879 F.2d at 120.

ments or settlements up to the specified limit of the policy. Second, the insurer undertakes to defend lawsuits brought against the insured and to pay the cost of the defense. In connection with this duty to defend, liability insurance policies generally vest the insurer with the exclusive right to conduct the defense and/or settlement of claims against the insured.⁶

III. DEVELOPMENTS IN WEST VIRGINIA'S LAW OF INSURANCE BAD FAITH BETWEEN 1974 AND 1995

In the early decades of the twentieth century, some states began to address issues involving insurance settlement practices.⁷ West Virginia did not join this movement until the mid-1970s.⁸ However, in the ensuing twenty years, the Supreme Court of Appeals of West Virginia not only established basic rules of insurance bad faith law, but it did so by adopting approaches that were novel — and, in some instances, unique — among the states.⁹ The development in West Virginia's law of insurance settlement practices emerged from legislation as well as three separate lines of cases.

First, in 1974, the West Virginia Legislature modified the Unfair Trade Practices Act (UTPA) to prohibit certain claims settlement practices by insurers.¹⁰ Seven years later, West Virginia became one of a handful of states to recognize a private cause of action under that statute by both the insured and the claimant.¹¹ Second, in 1990, the Supreme Court of Appeals of West Virginia adopted a unique hybrid negligence-strict liability standard for third-party insurance cases where the insured was held liable for a judgment in excess of policy limits.¹² Third, in 1986, West Virginia became the first jurisdiction to adopt a strict liability standard for bad faith claims involving first-party

6. *Id.* at 120-21.

7. *See infra* note 71 and accompanying text.

8. *See* discussion *infra* Part III.A.

9. *See* discussion *infra* Parts III.A. to III.C.

10. W. VA. CODE §§ 33-11-1 to -10 (1992).

11. *See* discussion *infra* Part III.A.

12. *See* discussion *infra* Part III.B.1.

insurance.¹³ Each of these three lines of development is examined in greater detail below.

A. *Statutory Bad Faith*

1. The West Virginia Unfair Trade Practices Act

In 1974, the West Virginia Legislature amended the UTPA to add additional provisions prohibiting fourteen separate “unfair claim settlement practices” ranging from failure to act promptly upon communications from insureds to failure to settle claims where liability had become reasonably clear.¹⁴ These enactments were based on model leg-

13. See discussion *infra* Part III.C.

14. These practices are set forth in W. VA. CODE § 33-11-4(9) (1992) (providing: Unfair claim settlement practices. — No person shall commit or perform with such frequency as to indicate a general business practice any of the following: (a) Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue; (b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies; (c) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies; (d) Refusing to pay claims without conducting a reasonable investigation based upon all available information; (e) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed; (f) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear; (g) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when such insureds have made claims for amounts reasonably similar to the amounts ultimately recovered; (h) Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application; (i) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured; (j) Making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which payments are being made; (k) Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration; (l) Delaying the investigation or payment of claims by requiring an insured, claimant or the physician of either to submit a preliminary claim

islation drafted by the National Association of Insurance Commissioners (NAIC).¹⁵ Over forty other states also adopted these model statutes by legislation or regulation.¹⁶

The stated purpose of the UTPA was "to regulate trade practices in the business of insurance . . . by defining, or providing for the determination of, all such practices in this State which constitute unfair methods of competition or deceptive acts or practices and by prohibiting the trade practices so defined or determined."¹⁷ The Insurance Commissioner was given authority to enforce the UTPA.¹⁸ If, after notice and hearing, the Commissioner determined that the UTPA had been violated, the Commissioner was granted the discretion to issue a cease and desist order and require the payment of a penalty or revoke the license of any company, broker, or agent who violated the Act.¹⁹ In addition, penalties were established for the violation of cease and desist orders.²⁰

report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information; (m) Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage; (n) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement; (o) Failing to notify the first party claimant and the provider(s) of services covered under accident and sickness insurance and hospital and medical service corporation insurance policies whether the claim has been accepted or denied and if denied, the reasons therefor, within fifteen calendar days from the filing of the proof of loss . . .).

15. See National Association of Insurance Commissioners, II *Laws and Legislation Committee Report*, 1960 PROCEEDINGS OF THE NAT'L ASS'N OF INS. COMMISSIONERS 515 exhibit D (1960); STEPHEN S. ASHLEY, *BAD FAITH: LIABILITY AND DAMAGES* 40 app. II (1994) [hereinafter ASHLEY]; PROPERTY INS. LAW COMM., *TORT AND INS. PRACTICE SECTION*, AM. BAR ASSOC., *BAD FAITH AND PUNITIVE DAMAGES: ANNOTATIONS TO FIRST-PARTY INSURANCE CASES, STATUTES, AND REGULATIONS* 329 (1986).

16. See Stephen S. Ashley, *The 1990 Amendments to the NAIC Model Unfair Trade Practices Act*, 7 *BAD FAITH L. RPT.* 213 (1991) [hereinafter *1990 Amendments*]; DENNIS J. WALL, *LITIGATION AND PREVENTION OF INSURER BAD FAITH* § 3.25 (2d ed. 1994).

17. W. VA. CODE § 33-11-1 (1992).

18. W. VA. CODE §§ 33-11-6 to -8 (1992).

19. W. VA. CODE § 33-11-6 (1992).

20. W. VA. CODE § 33-11-8 (1992).

2. *Jenkins v. J.C. Penney Casualty Insurance Co.*

During the 1970s, a number of cases throughout the country began to raise the question of whether private litigants could maintain a cause of action for an insurer's violation of the UTPA as adopted in various states. In 1979, the California Supreme Court issued its landmark decision in *Royal Globe Insurance Co. v. Superior Court*²¹ permitting third-party claimants to maintain direct actions against insurers under California's version of the UTPA. The Supreme Court of Appeals of West Virginia soon followed suit with its decision in *Jenkins v. J.C. Penney Casualty Insurance Co.*,²² thereby becoming one of the first jurisdictions to confront this issue.

Jenkins involved a claim by a plaintiff whose car had been damaged in a collision with another driver. The plaintiff sued the other driver's liability insurer directly and sought to recover for the property damages to the car, as well as for punitive damages and emotional distress damages. The plaintiff alleged that the insurer had violated its statutory duty under the UTPA by "not attempting in good faith to effectuate prompt, fair and equitable settlement of claims in which liability has become reasonably clear."²³ The Circuit Court for Cabell County dismissed the action on the ground that the statute could not be construed to give rise to a private cause of action.²⁴ On appeal, the Supreme Court of Appeals of West Virginia ruled that the trial court had erred.²⁵

In reaching this conclusion, the *Jenkins* court found that third-party claimants, as well as insureds, were within the class of persons protected by the language of the unfair claim settlement practices provisions of the UTPA.²⁶ The court then determined that an implied private cause of action should be recognized for violation of these provisions by an insurance company.²⁷ The conclusions of the *Jenkins*

21. 592 P.2d 329 (Cal. 1979).

22. 280 S.E.2d 252 (W. Va. 1981).

23. See W. VA. CODE § 33-11-4(9)(f) (1992).

24. *Jenkins*, 280 S.E.2d at 254.

25. *Id.*

26. *Id.* at 255-57.

27. *Id.* at 258. *Jenkins* also held, however, that a direct suit against the insurer could

court were expressly based not only on an analysis of West Virginia law, but also on decisions from other jurisdictions.²⁸ The court pointed out that, at the time of its decision, only two other cases had addressed the pertinent issues in any detail.²⁹

3. Interpretation of the UTPA in Other Jurisdictions

In the years since 1981, many more states have considered these issues. The overwhelming majority of these jurisdictions have concluded that no private cause of action should be recognized under the unfair claim settlement practice provisions of the UTPA.³⁰ A number of the reasons for this sharp reversal in the trend of decisions across the nation were identified by the California Supreme Court in 1987, when

not be maintained until after the underlying civil action had been ultimately resolved and accordingly affirmed the dismissal of the action against the insurer. *Id.* at 280.

28. *Id.* at 258 (noting decisions from Arizona, California, Illinois, Michigan, New Jersey, New York, and Washington).

29. *Jenkins*, 280 S.E.2d at 256 (referring to *Royal Globe Ins. Co. v. Superior Court*, 592 P.2d 329 (Cal. 1979) and *Scroggins v. Allstate Ins. Co.*, 393 N.E.2d 718 (Ill. Ct. App. 1979)).

30. *E.g.*, *O.K. Lumber Co. v. Providence Washington Ins. Co.*, 759 P.2d 523, 526-27 (Alaska 1988); *Moradi-Shalal v. Firemen's Fund Ins. Cos.*, 758 P.2d 58, 59-60 (Cal. 1988); *Farmer's Group, Inc. v. Trimble*, 658 P.2d 1370, 1377-78 (Colo. Ct. App. 1982), *aff'd*, 691 P.2d 1138 (Colo. 1984); *Playtex FP, Inc. v. Columbia Casualty Co.*, No. CIV.A.88 C-MR-233, 1993 WL 54504, at *2 (Del. Super. Ct. 1993); *Greene v. Truck Ins. Exch.*, 753 P.2d 274, 279-80 (Idaho Ct. App. 1988), *review denied*, 776 P.2d 829 (Idaho 1989); *Bates v. Allied Mut. Ins. Co.*, 467 N.W.2d 255, 260 (Iowa 1991); *King v. Federal Ins. Co.*, 788 F. Supp. 506, 507 (D. Kan. 1992), *aff'd*, 996 F.2d 311 (10th Cir. 1993) (construing Kansas law); *Morris v. American Family Mut. Ins. Co.*, 386 N.W.2d 233, 235-38 (Minn. 1986); *Tufts v. Madesco Inv. Co.*, 524 F. Supp. 484, 487 (E.D. Mo. 1981); *Gunny v. Allstate Ins. Co.*, 830 P.2d 1335, 1336 (Nev. 1992); *Pierzga v. Ohio Casualty Group*, 504 A.2d 1200, 1204 (N.J. Super. Ct. App. Div.), *cert. denied*, 517 A.2d 402 (N.J. 1986); *Rocanova v. Equitable Life Assurance Soc'y*, 634 N.E.2d 940, 944-45 (N.Y. 1994); *Strack v. Westfield Cos.*, 515 N.E.2d 1005, 1007-08 (Ohio Ct. App. 1986); *McWhirter v. Fire Ins. Exch. Inc.*, 878 P.2d 1056, 1057-58 (Okla. 1994); *Swinton v. Chubb & Son, Inc.*, 320 S.E.2d 495, 496-97 (S.C. Ct. App. 1984); *Wilder v. Aetna Life & Casualty Ins. Co.*, 433 A.2d 309, 310 (Vt. 1981); *A&E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 673-76 (4th Cir. 1986) (construing Virginia law); *Kranzush v. Badger State Mut. Casualty Co.*, 307 N.W.2d 256, 266-69 (Wis. 1981). *But see* *State Farm Mut. Auto. Ins. Co. v. Reeder*, 763 S.W.2d 116, 118 (Ky. 1988); *Klaudt v. Fink*, 658 P.2d 1065, 1066-67 (Mont. 1983).

its decision in *Moradi-Shalal v. Fireman's Fund Insurance Cos.*³¹ overruled *Royal Globe*.³²

The California Supreme Court emphasized the adverse social and economic consequences that the state had suffered as a result of its earlier decision.³³ The court cited reports indicating that *Royal Globe* promoted multiple litigation thereby draining California's judicial resources.³⁴ In the words of the California Supreme Court, the private cause of action "contemplates, indeed encourages, two lawsuits by the injured claimant: an initial lawsuit against the insured, followed by a second suit against the insurer for bad faith refusal to settle."³⁵ *Moradi-Shalal* further pointed to reports that the implied statutory action encouraged unwarranted settlement demands by claimants and coerced insurers to agree to inflated settlements in order to avoid the cost of a second lawsuit and exposure to a bad faith action.³⁶ These consequences, according to the California Supreme Court, adversely affected the general public in the form of escalating insurance costs as insurers sought to recoup their increased expenditures on inflated settlements, jury awards in statutory actions, and added attorney fees.³⁷

31. 758 P.2d 58 (Cal. 1987).

32. *Id.* at 66.

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. See *Moradi-Shalal*, 758 P.2d at 64-65. The intent of the framers of the model act, together with the absence of any direct indication of a legislative intention to create a new action, led the California Supreme Court to conclude that *Royal Globe's* statutory analysis had also been faulty. The court criticized *Royal Globe's* assertion that the "savings clause" of the California statute, which provided that administrative actions by the Insurance Commissioner for violation of the statute would not "relieve or absolve" an insurer from "any civil liability . . . under the laws of this State," demonstrated a legislative intention to create a private cause of action. *Id.* at 61 (citation omitted). Instead, the *Moradi-Shalal* court took the view that more direct and precise language would have been used if the legislature had intended to create a new action. The court also observed that NAIC, in formulating the model legislation, expressly rejected a provision that would have created a private cause of action. *Id.* at 63-64.

Indeed, NAIC itself has emphasized that its "original intent" was to preclude such actions because "[t]his Act is inherently inconsistent with a private cause of action." National Association of Insurance Commissioners, II *Market Conduct and Consumer Affairs Subcommittee*, 1990 PROCEEDINGS OF THE NAT'L ASS'N OF INS. COMMISSIONERS 177 (1990);

4. Practical Ramifications of *Jenkins* and Its Progeny

To date, the Supreme Court of Appeals of West Virginia has not chosen to revisit its central ruling in *Jenkins*.³⁸ Rather, during the first half of the 1990s, the court addressed a variety of individual issues stemming from the implied private cause of action created in *Jenkins*. One recurring issue involved the timing for filing such actions. In 1991, the court was asked to clarify the meaning of *Jenkins*' statement that actions for violation of the UTPA could not be maintained until the underlying suit was "ultimately resolved."³⁹ The court concluded in *Robinson v. Continental Casualty Co.*⁴⁰ that "ultimately resolved" meant "resolved after any and all appeals" and held that the commencement of a statutory action was premature until the appellate process had been completed in the underlying action. This pre-determination rule was reaffirmed in 1993.⁴¹

In 1994, however, the Supreme Court of Appeals of West Virginia announced that it was overruling *Jenkins*, *Robinson*, and other cases to the extent that those decisions held that a statutory action could not be joined in the same complaint as the underlying personal injury suit against the insured.⁴² The court in *State ex rel. State Farm v. Mad-*

see 1990 Amendments, supra note 16.

38. There are, however, some indications that West Virginia may be experiencing certain of the adverse economic consequences that were noted in California in the years following *Royal Globe*. Recently, the NAIC issued a nationwide study concerning average expenditures and premiums for personal automobile insurance between 1989 and 1993. NATIONAL ASS'N OF INS. COMM'RS, STATE AVERAGE EXPENDITURES & PREMIUMS FOR PERSONAL AUTOMOBILE INSURANCE IN 1993 (1995). This report indicated that, during the period studied, the average premium for private passenger automobile liability insurance in West Virginia increased by approximately 44 percent. *Id.* tbl. 4. This increase was more than double the nationwide average increase of 21 percent during the same period. *Id.* Similarly, West Virginia's average premium for private passenger automobile collision insurance likewise reportedly increased by approximately 20 percent during this period, as opposed to a nationwide average increase of approximately 4 percent. *Id.* tbl. 5.

39. *Jenkins*, 280 S.E.2d at 259.

40. 406 S.E.2d 470, 471-72 (W. Va. 1991).

41. *Russell v. Amerisure Ins. Co.*, 433 S.E.2d 532, 533-34 (W. Va. 1993).

42. *State ex rel. State Farm Fire & Casualty Co. v. Madden*, 451 S.E.2d 721, 725 (W. Va. 1994).

*den*⁴³ held that a party bringing a personal injury action against a tortfeasor could also sue the tortfeasor's liability insurer for statutory violations (including a failure to settle) prior to the time the claimant had obtained a judgment against the alleged tortfeasor. However, the court required that the claims made against the insurer be bifurcated from those against the insured, and that any discovery or proceedings against the insurer be stayed pending resolution of the underlying claim against the insured.⁴⁴ The reason for this decision was the court's concern that the filing fees associated with initiating the second action were becoming "a more and more oppressive burden on ordinary working people."⁴⁵

In emphasizing this interest, the court may have inadvertently threatened the traditional goals it has long espoused in its UTPA jurisprudence — encouraging settlements⁴⁶ and cutting the costs of litigation.⁴⁷ For example, third-party claimants now routinely threaten and file statutory bad faith claims against insurers while they are still pursuing claims against the alleged tortfeasor.⁴⁸ Prior to the resolution of claims against the alleged tortfeasor, disputes about whether the insured's liability is "reasonably clear" abound. However, once claims of statutory bad faith are filed, these claims may be maintained as a matter of course (as opposed to a matter of analysis) even after the underlying action is resolved. Thus, permitting the filing of statutory claims before resolution of the underlying claims against the tortfeasors may well engender additional litigation.⁴⁹

43. *Id.*

44. *Id.*

45. *Id.*

46. *Jenkins*, 280 S.E.2d at 258.

47. *Madden*, 451 S.E.2d at 725.

48. See Brief Amici Curiae of the American Insurance Association, et al., at 11 n.14, *Poling v. Motorists Mut. Ins. Co.*, 450 S.E.2d 635 (W. Va. 1994) (No. 22135) (discussing reports received from members of the Defense Trial Counsel of West Virginia).

49. By allowing statutory claims against an insurer to be joined in the same complaint as the underlying personal injury claims against the insured, *Madden* increases the chance that the same attorney will represent the plaintiff on both claims. This situation entails potential problems because the conduct and evaluations of plaintiff's counsel are often at issue in cases of alleged "bad faith" failure to settle cases. See, e.g., *Zweig v. Safeco Ins. Co.*, 509 N.Y.S.2d 320, 321 (N.Y. App. Div. 1986).

Moreover, the Supreme Court of Appeals of West Virginia's ruling in *Poling v. Motorists Mutual Insurance Co.*⁵⁰ unwittingly contributed to this result. In *Poling*, the court held that a statutory action could go forward where the underlying action had been settled, even though no judgment against the insured was obtained.⁵¹ The court stated that:

[A] cause of action for insurance bad faith may arise even if there has been a settlement and release so long as the release does not cover the insurer and the insurer is, or should be, aware of the possibility of a bad faith action at the time it agrees to the settlement.⁵²

Although the *Poling* decision was intended to protect claimants, it has placed insurers and insureds in a dilemma where their interests may not be aligned. After *Poling*, a careful insurer may insist on a release of any bad faith claims before settling a claim. However, insisting on such a release might delay or destroy a settlement. Because the insured typically is only interested in resolving the claim against him or her, the insured may see the insurer's refusal to settle as an act

Except in limited circumstances, an attorney who seeks to serve as both attorney and witness in such cases will encounter ethical rules prohibiting this dual role. See WEST VIRGINIA RULES OF PROFESSIONAL CONDUCT Rule 3.7 cmt. (1995). If an attorney attempts to resolve this conflict by remaining in the case solely as counsel, the client may be deprived of testimony necessary for the pending claim. If, on the other hand, an attorney belatedly recognizes the conflict and withdraws as counsel in order to act as a witness, the litigation is likely to be delayed and the plaintiff may incur added costs as a new attorney becomes familiar with the matter. *Madden* thus encourages a conflict situation that cannot be resolved without adverse consequences.

In addition, it should be noted that the bringing of a "bad faith" claim may waive the attorney-client privilege or the work product doctrine with respect to the attorney's actions in the underlying suit. Courts have held that in suing an insurance carrier, plaintiffs bring their own conduct and the conduct of their counsel in the underlying proceedings directly into issue and insurers are entitled to inspect documents pertaining to the underlying proceedings regardless of whether they contain attorney work product or communications normally protected by the attorney-client privilege. See *Potomac Elec. Power Co. v. California Union Ins. Co.*, 136 F.R.D. 1, 4 (D.C. 1990); see also *Metro Wastewater Reclamation Dist. v. Continental Casualty Co.*, 142 F.R.D. 471, 477 (D. Colo. 1992); *Charlotte Motor Speedway, Inc. v. International Ins. Co.*, 125 F.R.D. 127, 130 (M.D.N.C. 1989); *Truck Ins. Exch. v. St. Paul Fire & Marine Ins. Co.*, 66 F.R.D. 129, 136 (E.D. Pa. 1975).

50. 450 S.E.2d 635 (W. Va. 1994).

51. *Id.*

52. *Id.* at 637.

of bad faith even when the claimant's bad faith claims are wholly unfounded.⁵³ To avoid this dilemma, insurers may choose to litigate questionable claims because a settlement will not conclude the litigation. Thus, in practice, a statute and court precedents that are designed to reduce litigation costs, encourage the settlement of claims, and protect both the claimant and the insured may have the opposite effect of encouraging further litigation between the parties and discouraging the very settlement that could resolve those claims.⁵⁴

Further practical ramifications of the Supreme Court of Appeals of West Virginia's UTPA decisions have become apparent in connection with the requirement that plaintiffs prove that the insurer "commit[ted] or perform[ed] [the unfair claim settlement practice] with such frequency as to indicate a general business practice."⁵⁵ In *Russell v. Amerisure Insurance Co.*,⁵⁶ the court emphasized that more than a single isolated violation of the unfair claim settlement practices statute must be shown for the plaintiff to establish a general business practice. The court found that alleged violations of five different subsections of West Virginia Code Section 33-11-4(9) did not meet this requirement because the factual basis for each violation was the same isolated scenario.⁵⁷

Although insurance commissioners are privy to information describing insurers' business practices, private litigants are not. Thus, litigants have sought to use the discovery process to develop information sufficient to meet this statutory requirement. In *State Farm Mutual Automobile Insurance Co. v. Stephens*,⁵⁸ the Supreme Court of Ap-

53. Cf. *ASHLEY*, *supra* note 15, § 10.07, at 8-9.

54. Moreover, even in situations where the interests of the insurer and the insured are aligned, the *Poling* rule carries the potential for depriving both parties of a major benefit of settlement. When, pursuant to *Poling*, a settlement of the underlying action is followed by a statutory action, the second action will require the claimant to establish that the insured's liability was "reasonably clear" in the underlying action. Thus, one of the benefits of settling the underlying action — avoiding the need to litigate the insured's liability — is lost by both the insurer and the insured. This circumstance appears likely to diminish the attractiveness of settlement.

55. W. VA. CODE § 33-11-4(9) (1992).

56. 433 S.E.2d 532, 536 (W. Va. 1993).

57. *Id.*

58. 425 S.E.2d 577, 583-84 (W. Va. 1992).

peals of West Virginia addressed the permissible scope of discovery in statutory causes of action and made clear that plaintiffs would not be permitted to conduct unduly burdensome and oppressive discovery in their effort to obtain evidence of an insurer's "general business practice." The court recognized that in a bad faith claim against a carrier, previous "similar" acts are relevant to a bad faith claim, but refused to allow interrogatories that requested the insurer to "provide information on every claim filed against it, nationwide, since 1980 which involved allegations of bad faith, unfair trade practice violations, excess verdict liability or inquiries from insurance industry regulators concerning State Farm's handling of claims."⁵⁹ The court limited discovery, at least in the first instance, to "other similar claims filed against [the insurer] in West Virginia."⁶⁰

While the limitation imposed by *Stephens* appears sound and workable, it too has engendered uncertainties. Insurers have been quick to contend that other claims are factually distinguishable and claimants have asserted that any claims involving the same insurer are "similar." At trial, some courts have allowed other disgruntled claimants to testify about their experiences, which has resulted in trials within trials.⁶¹ Plaintiffs also have been permitted simply to introduce at trial records of all bad faith claims filed against the insurer in West Virginia.⁶² The insurer is then permitted to explain each claim — a time consuming and ultimately non-probative exercise.

5. The Need for Clarification

A solution to these problems is not easily achieved. Nevertheless, it appears that the Supreme Court of Appeals of West Virginia may wish to clarify its rulings and provide additional guidance on several recurring issues in the application of the statute. Such guidance seems

59. *Id.* at 580.

60. *Id.* at 585.

61. See Petition for Appeal at 23-25, *Quail Ridge Golf Club, Inc. v. Liberty Mut. Ins. Co.* (W. Va. 1993) (No. 90-C-117) (describing admission at trial of testimony by third-party concerning previous bad experience with defendant insurer).

62. *Id.* at 12-23 (describing admission into evidence of 137 individual complaints filed with West Virginia Insurance Commissioner against defendant insurer).

especially appropriate in connection with the "general business practice" requirement. The court has taken a useful first step in *Stephens* by indicating that evidence relevant to this element should involve "similar" acts by the insurer in question.⁶³ This issue could be further clarified by a requirement that plaintiffs introduce evidence showing that the insurer, when handling claims in West Virginia of the same type as the plaintiff's claim and during the same time period as when the plaintiff's claim was pending, regularly committed the same type of statutory violation allegedly committed against the plaintiff. Clarification along these lines would not only reduce the drain on judicial resources from multiple trials within trials, but also might well encourage litigants to focus their discovery efforts and thereby reduce the enormous litigation costs engendered by overbroad discovery.

The court may also reduce the unintended consequences of its UTPA decisions by strictly enforcing the requirement that the conduct at issue be performed with such frequency as to indicate a general business practice. Claims involving unique programs, such as retrospective premiums or large self-insured retentions where the insured controls the handling of the claims should not, by definition, be subject to most of the Act's provisions.⁶⁴ By their nature, these programs are individually designed and the insurer's actions with respect to these programs are not probative when the claim involves a more typical insurance program. In addition, because the insurer lacks control over the claims, it should not be held liable under the Act if the insured is disinclined to settle a claim.

63. *Stephens*, 425 S.E.2d at 584.

64. Large corporate and private entities often purchase insurance with high deductibles or large retentions that, practically speaking, make them self-insured for certain losses. Other large insureds purchase policies that have retrospective premiums where an initial premium is charged and then adjusted at the end of the policy year (and thereafter) to reflect the actual loss experience of the business. These programs vary considerably and, in certain of the programs, there is no risk transfer or none until a specified amount of loss is paid. Under many programs with retrospective premiums, large deductibles, or self-insured retentions, the insurer handles claims for the policyholder, but the money that is spent is the insured's. In these circumstances, the insured may have considerable control concerning what claims are paid and in what amounts.

Finally, the court may consider returning to its pre-*Madden* rule regarding the timing of statutory actions. In *Jenkins, Robinson, and Russell*, the court recognized that an important reason for delaying the filing of the statutory action was that “once the underlying claim is resolved, the claimant may be sufficiently satisfied with the result so that there will be no desire to pursue the statutory claim.”⁶⁵ Similarly, the court pointed out that “it is not until the underlying suit is concluded that the extent of reasonable damages in the statutory action will be known.”⁶⁶

Although the court’s concern with the burden of multiple filing fees should not be minimized, alternative means might be used to address the problem. West Virginia law expressly provides for the waiver of the filing fee (presently set at \$70.00) if financial hardship to the plaintiff would result.⁶⁷ In addition, insureds and claimants who prevail under the statute will be reimbursed for these costs as a part of their statutory fees.⁶⁸ If the Supreme Court of Appeals of West Virginia were to permit the circuit courts to exercise judiciously their right to waive fees in appropriate cases, the court could once again obtain the significant benefits that it has recognized as flowing from its pre-determination rule. The court, therefore, could return to its well-reasoned analysis in *Jenkins, Robinson, and Russell* without imposing a burden on indigent claimants.

B. *Third-Party Common Law Bad Faith*

Historically speaking, the concept of common law bad faith first emerged in the third-party insurance context.⁶⁹ The classic fact pattern giving rise to this concept occurred where a plaintiff sued for damages

65. *Russell*, 433 S.E.2d at 534; *Robinson*, 406 S.E.2d at 471; *Jenkins*, 280 S.E.2d at 259.

66. *Russell*, 433 S.E.2d at 534; *Robinson*, 406 S.E.2d at 471; *Jenkins*, 280 S.E.2d at 259.

67. See W. VA. CODE §§ 59-1-11, 59-2-1 (Supp. 1995); W. VA. R. CIV. P. 77(e).

68. See W. VA. CODE § 59-2-8 (1994).

69. See ASHLEY, *supra* note 15, § 1.02 (discussing early development of bad faith law); ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE §§ 5A.02-03 (1995) (same).

in an amount that exceeded the limits of a defendant's liability insurance policy.⁷⁰ Under such liability policies, the insurer typically controlled the defense of the lawsuit and the decision whether to settle. Thus, when the plaintiff proposed to settle for an amount at or slightly below policy limits, a potential conflict arose because the insurer would incur little or no additional risk by rejecting the plaintiff's proposal and proceeding to trial in hopes of obtaining a defense verdict. The insured, on the other hand, would be exposed to significant additional liability if an unfavorable verdict in excess of the policy limits were returned.

In the early decades of the twentieth century, courts across the country began to develop caselaw placing on insurers the duty to consider a settlement in such circumstances.⁷¹ In cases where an insurer's decision to proceed to trial was followed by an excess verdict, these jurisdictions articulated a variety of standards for determining whether the insurer's decision was improper and therefore subjected the insurer to liability for the full amount of the judgment.⁷² Some jurisdictions held that only good faith toward the insured was required in such circumstances, while other jurisdictions required that both good faith and ordinary care be exercised by the company in deciding not to settle.⁷³

The settlement-related tensions inherent in third-party liability insurance were recognized in West Virginia at an early date.⁷⁴ The matter, however, remained unaddressed by the Supreme Court of Appeals. As a result, commentators speculated on which of the various standards used in other jurisdictions would be chosen to govern in West Virginia.⁷⁵ The federal courts likewise attempted to discern the proba-

70. See, e.g., *Crisci v. Security Ins. Co.*, 426 P.2d 173 (Cal. 1967).

71. See Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1138-39 (1954).

72. See *Id.* at 1139-40 (surveying the emerging standards used in various states to define the duty to settle).

73. *Id.*

74. See, e.g., P.H. VARTANIAN, *THE LAW OF AUTOMOBILES IN VIRGINIA AND WEST VIRGINIA*, 415-16 (1928).

75. Richard Edwin Rowe, Comment, *Insurance-Recovery of Excess Judgment from Insurance Company*, 70 W. VA. L. REV. 98, 103 (1967) (predicting that "it is most likely

ble course of West Virginia law when called upon to decide cases that involved the issue.⁷⁶

In 1966, the question was squarely presented to the Supreme Court of Appeals of West Virginia in *Speicher v. State Farm Mutual Automobile Insurance Co.*⁷⁷ When the *Speicher* opinion was subsequently issued, however, it discussed at some length the bad faith and negligence standards employed in other states, but resolved the case without finding it necessary to adopt either of the competing standards.⁷⁸ This fundamental aspect of the law of insurance settlement practices thereafter remained undecided in West Virginia for an additional twenty years.⁷⁹

1. *Shamblin v. Nationwide Mutual Insurance Co.*

In early 1990, the Supreme Court of Appeals of West Virginia agreed to hear *Shamblin v. Nationwide Mutual Insurance Co.*,⁸⁰ in which the Circuit Court of Kanawha County had allowed an insured to recover from its liability insurer the full amount of a judgment in excess of policy limits that had followed the insurer's failure to settle the claims against the insured. In reaching this result, the trial court had reviewed the insurer's conduct under a negligence standard.⁸¹ On appeal, the insurer sought reversal on the ground that application of a negligence standard was erroneous and that a bad faith standard was

that when the West Virginia Supreme Court of Appeals is confronted with the question they will follow the majority and require that refusal to settle be a 'good faith' refusal").

76. *Inland Mut. Ins. Co. v. Peerless Ins. Co.*, 152 F. Supp. 506 (S.D.W. Va. 1957), *aff'd*, 251 F.2d 696 (4th Cir. 1958).

77. 151 S.E.2d 684 (W. Va. 1966).

78. *Id.* at 685-86, 689.

79. During this period, the federal courts continued to decide cases brought against insurers for wrongfully failing to settle cases that resulted in excess verdicts against insureds. See *Daniels v. Horace Mann Mut. Ins. Co.*, 422 F.2d 87 (4th Cir. 1970); *Vencill v. Continental Casualty Co.*, 433 F. Supp. 1371 (S.D.W. Va. 1977).

80. 396 S.E.2d 766, 773 (W. Va. 1990).

81. *Id.*

appropriate.⁸² The insured, on the other hand, argued on appeal that a standard of strict liability should be applied.⁸³

When the court subsequently issued its opinion in *Shamblin*, it emphasized that it was deciding an issue of first impression in West Virginia and discussed at length the competing standards used by other courts in determining whether an insurer had met its duty to its insured regarding the settlement of third-party claims.⁸⁴ The court then announced the “standard of proof . . . applicable in future actions against insurers by their insureds for failure to settle third-party liability claims against them within policy limits.”⁸⁵ *Shamblin* adopted “a hybrid negligence-strict liability standard” that followed the reasoning of certain cases from other jurisdictions applying a negligence standard, but took “the concepts embodied therein one step further.”⁸⁶

In specific terms, this new standard was based on the proposition that an insurer would be deemed to have acted in prima facie bad faith toward its insured whenever “there is a failure on the part of an insurer to settle within policy limits where there exists the opportunity to settle and where such settlement within limits would release the insured from any and all personal liability.”⁸⁷ In such circumstances, the court held that the insurer would then have the burden of proving by clear and convincing evidence that it “attempted in good faith to negotiate a settlement, that any failure to enter into a settlement where the opportunity to do so existed was based on reasonable and substantial grounds, and that it accorded the interests and rights of the insured at least as great a respect as its own.”⁸⁸ The *Shamblin* court further provided a non-exhaustive list of factors to be considered in determining whether the insurer’s conduct complied with this standard.⁸⁹

82. *Id.*

83. *Id.*

84. *Id.*

85. *Shamblin*, 396 S.E.2d at 775.

86. *Id.* at 776.

87. *Id.* at 781.

88. *Id.*

89. The court set forth the following factors that must be considered:

1. Whether the reasonably prudent insurer would have refused to settle within policy limits under the facts and circumstances of the case, bearing in mind always its

In this manner, *Shamblin* established a standard in the third-party context that intentionally went “one step further” than the rules in other jurisdictions.⁹⁰ The court made clear that the source of these settlement obligations was the insurer’s “very strong obligation of good faith to its insured” — a duty that was particularly important where a liability insurer has control over settlement negotiations.⁹¹

2. Practical Ramifications of *Shamblin*

Because a relatively short period of time has elapsed since *Shamblin*, the practical ramifications of the decision have not yet fully emerged. One of the immediate consequences of *Shamblin*, however, has been a degree of uncertainty over the standard to be applied in excess verdict cases. As noted earlier, *Shamblin* expressly rejected a pure strict liability standard in favor of a hybrid standard that permits

duty of good faith and fair dealing with its insured;

2. Whether there was an appropriate investigation and evaluation of the claim based upon objective and cogent information;

3. Whether the insurer had a reasonable basis to conclude that there was a genuine and substantial issue as to liability of its insured; and

4. Whether there was a potential for substantial recovery of an excess verdict against its insured.

Id. at 776. The court cautioned that this list was not to be considered exhaustive and that any “salient fact or circumstance regarding the reasonableness of the insurer’s actions, and its concern or lack of concern for the protection of its insured, may be considered in determining whether the insurer is liable to its insured for any judgment obtained against him in excess of policy limits.” *Id.* at 777.

90. Various commentators have agreed with the court’s assertion that the *Shamblin* standard constituted a novel departure from existing approaches. *See, e.g.*, ASHLEY, *supra* note 15, § 3.22 (stating that “the West Virginia Supreme Court has come closer than any to adopting strict liability in third-party cases”); JOHN C. MCCARTHY, RECOVERY OF DAMAGES FOR BAD FAITH § 2.26 (5th ed. 1990 & Supp. 1995) (stating that West Virginia “has come close to adopting a strict liability standard for failure-to-settle cases, and has placed an unusual burden of proof upon the insurer”); PAT MAGARICK, EXCESS LIABILITY: THE LAW OF EXTRA-CONTRACTUAL LIABILITY OF INSURERS § 10.04 (3d ed. 1994) (describing the *Shamblin* holding as “unusual”).

91. *Shamblin*, 396 S.E.2d at 774-76 (discussing decision of Supreme Court of New Hampshire in *Dumas v. Hartford Accident & Indemnity Co.*, 56 A.2d 57 (N.H. 1947) and adopting reasoning thereof); *see also Weese*, 879 F.2d at 120-21 (finding that insurer’s duty to its insured under third-party liability policy rested on insurer’s exclusive reservation of right to negotiate settlement).

insurers to prevail if their settlement conduct was based on reasonable and substantial grounds.⁹² Nevertheless, in the years following the decision, one member of the Supreme Court of Appeals of West Virginia continued to speak in favor of applying a strict liability standard.⁹³ Under these circumstances, some trial courts improperly imposed liability on insurers for excess judgments without holding any trial or hearing whatsoever concerning the reasonableness of the insurer's conduct.⁹⁴

In the coming years, the West Virginia courts undoubtedly will continue to be asked to apply the *Shamblin* standard to factual scenarios that, as the West Virginia Supreme Court of Appeals has observed, are "as varied and endless as the imagination."⁹⁵ Thus, one of the challenges facing the court will be to ensure that the standard established in *Shamblin* is implemented in a manner consistent with the court's explicit rejection of a strict liability standard. The long-term practical ramifications of *Shamblin* will depend heavily on the court's success in this endeavor.⁹⁶

92. See *supra* note 88 and accompanying text.

93. *Charles*, 452 S.E.2d at 389 (opinion by Justice Neely noting that his concurring opinion in *Shamblin* indicated that he would go "even farther than the majority" and adopt an "absolute liability standard"); *Shamblin*, 396 S.E.2d at 781 (Neely, J., concurring).

94. See *Marshall*, 450 S.E.2d at 799; *Charles*, 452 S.E.2d at 388-89.

95. *Shamblin*, 396 S.E.2d at 776.

96. The practical ramifications of adopting a strict liability standard in the duty-to-settle context have been the subject of scholarly attention. See, e.g., Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113, 1168 (1990) [hereinafter *Duty to Settle*]. Commentators have found such a standard troubling because it would impose liability on insurers even in cases where the plaintiff's settlement demand significantly exceeds the expected judgment and any rational defendant would have rejected the demand. *Id.* at 1170. The strict liability standard also has been criticized for its economic effects. Because such a standard would effectively "cause[] liability limits to vanish if the plaintiff makes a demand within the limits at any time in the litigation," commentators have concluded that insurers would need to increase premiums in order to take into account the increased risks that would accompany coverage. *Id.* at 1169; ROBERT E. KEETON AND ALAN I. WIDISS, *INSURANCE LAW* § 7.8(b)(4), at 887-89 (1988). Premiums would increase further as insureds who previously purchased high limits coverage switch to low limits coverage because of the protection given to them by strict liability. See *Duty to Settle*, at 1170. Thus, under this view, the net effect of adopting a strict liability standard would be "to increase the cost of all policies while narrowing the price differential between low and high-limits coverage." *Id.*

C. *First-Party Common Law Bad Faith: Hayseeds, Inc. v. State Farm Fire & Casualty Co.*

Although some courts began to expand the concept of bad faith from the third-party insurance context to the first-party context in the early 1970s,⁹⁷ the Supreme Court of Appeals of West Virginia did not weigh in on this new area of bad faith law until 1986 when it issued its opinion in *Hayseeds, Inc. v. State Farm Fire & Casualty*.⁹⁸

In *Hayseeds*, the court considered a verdict entered in the Circuit Court of Mason County against an insurer that had declined to pay a property damage claim on the grounds of arson.⁹⁹ In the trial court, the jury found that arson had not been proven and the insureds were awarded an amount under the policy for their property damages, as well as additional amounts for attorneys' fees and consequential damages arising from the insurer's denial of their claim.¹⁰⁰ On appeal, the insurer argued, *inter alia*, that it should not be held liable for extra-contractual damages because it had a reasonable basis for denying the insured's claim.¹⁰¹

The *Hayseeds* court noted that other jurisdictions had held that when an insurer wrongfully withholds or unreasonably denies payment of an insured's first-party insurance claim, the insurer was liable for all foreseeable consequential damages naturally flowing from the delay.¹⁰² The court criticized these other courts for basing their decisions on "judicial interpretation of such malleable and easily manipulated concepts as 'reasonable,' 'unreasonable,' 'wrongful,' 'good faith,' and 'bad faith.'" ¹⁰³ Instead, the court stressed the need for a clear, bright-line standard governing the availability of consequential damages

97. See, e.g., *Fletcher v. Western Nat'l Life Ins. Co.*, 89 Cal. Rptr. 78 (Cal. Ct. App. 1970); *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973). See generally ASHLEY, *supra* note 15, §§ 2.10 to .14 (discussing historical development of first-party "bad faith").

98. 352 S.E.2d 73 (W. Va. 1986).

99. *Id.* at 75.

100. *Id.* at 76.

101. *Id.* at 80.

102. *Id.*

103. *Id.*

in property damage insurance cases.¹⁰⁴ Accordingly, the court held that “when a policyholder substantially prevails in a property damage suit against an insurer, the policyholder is entitled to damages for net economic loss caused by the delay in settlement, as well as an award for aggravation and inconvenience.”¹⁰⁵ The court allowed attorney’s fees as a part of net economic loss,¹⁰⁶ but held that punitive damages could only be awarded if the refusal to pay the claim was accompanied by a malicious intention to injure or defraud.¹⁰⁷

In the context of first-party bad faith, as in the area of third-party bad faith, the Supreme Court of Appeals of West Virginia thus established a position that went beyond the approaches used in other jurisdictions¹⁰⁸ and eliminated the role of bad faith in first-party property insurance cases. This strict liability standard was based explicitly on the nature of the relationship between an insurer and its insured. “[W]hen an insured purchases a contract of insurance,” the *Hayseeds* court stated, “he buys insurance — not a lot of vexatious, time-consuming, expensive litigation with his insurer.”¹⁰⁹

104. *Id.*

105. *Id.*

106. The court held that attorney’s fees are presumptively one-third of the face amount of the policy. *Id.*

107. *Id.* at 80. The court noted that the high threshold of actual malice requires that “the company actually knew that the policyholder’s claim was proper, but willfully, maliciously and intentionally denied the claim.” *Id.* at 80-81. The court specifically stated that it intended this to be a “bright line standard, highly susceptible to summary judgment for the defendant.” *Id.* at 81.

108. Based on *Hayseeds*, West Virginia has been recognized as “the one jurisdiction to adopt a strict liability standard in first-party cases.” ASHLEY, *supra* note 15, § 5.03.

109. *Hayseeds*, 352 S.E.2d at 79. Although *Hayseeds* was decided in 1986, the practical ramifications of the decision in West Virginia have not been well-documented. This situation may be at least partially attributable to the fact that *Hayseeds* was, by its terms, limited to property damage claims. Given the court’s recent extension of *Hayseeds* to uninsured/underinsured motorist coverage and, by implication, all first-party claims, *see infra*, Part III.D. (discussing *Marshall v. Saseen* and *Hadorn v. Shea*), the ramifications of the decision may become more pronounced in the future.

D. Hybrid Cases Involving Third-Party and/or First-Party Common Law Bad Faith

By the early 1990s, the Supreme Court of Appeals of West Virginia had adopted a strict liability standard for first-party bad faith claims and a negligence-strict liability standard for third-party claims where the insured was subjected to a judgment in excess of policy limits. In 1994, the court was presented with a hybrid first/third-party claim in the uninsured/underinsured motorist coverage area. In *Marshall v. Saseen*¹¹⁰ the tortfeasor defendant in a personal injury action was defended at trial by the *plaintiff's* underinsured motorist carrier. Prior to trial, the carrier rejected a policy limits settlement demand by the plaintiff-insured. The jury subsequently returned a verdict in excess of the policy limits.¹¹¹ Thereafter, the trial court ruled that the insurer was guilty of bad faith as a matter of law and, without holding a trial, entered judgment against the insurer for the excess judgment.¹¹² When the insurer challenged the trial court's actions on appeal, the court issued rulings implicating both first-party and third-party bad faith issues.

As an initial matter, the *Marshall* court addressed the applicability of the *Hayseeds* doctrine in the context of uninsured/underinsured motorist insurance. This issue arose from the plaintiff's claim for attorney fees and consequential damages allegedly incurred because the insurer had refused to settle and the insured, therefore, had been forced to proceed to trial.¹¹³ The court noted that *Hayseeds* and its progeny involved insurance policies covering property damages, but stated that "we can see no reason why these principles should not apply to uninsured and underinsured motorist coverage."¹¹⁴ The court emphasized that the critical point was that uninsured and underinsured motorist coverage, like property damage coverage, *constituted first-party insur-*

110. 450 S.E.2d 791 (W. Va. 1994).

111. *Id.* at 794.

112. *Id.*

113. *Id.* at 797.

114. *Id.*

ance.¹¹⁵ Under both types of insurance, the court reasoned, the insurer had directly contracted with the insured to provide coverage up to the policy limits.¹¹⁶ Therefore, the *Marshall* court held that:

[W]hen a policy holder of uninsured or underinsured motorist coverage issued pursuant to W. Va. Code 33-6-31(b) substantially prevails in a suit involving such coverage under W. Va. Code 33-6-31(d), the insurer is liable for the amount recovered up to the policy limits, the policyholder's reasonable attorney fees, and damages proven for aggravation and inconvenience.¹¹⁷

Although the court found that uninsured and underinsured motorist coverage cases involved first-party coverage, the court also held that the insurer was liable for amounts in excess of the policy limits under the third-party doctrine announced in *Shamblin*.¹¹⁸ The court insisted that, because the plaintiff's claim was based on the contention that the insurer acted in bad faith in assessing the underlying tort action and failing to settle within policy limits, the issues should be resolved "in a manner substantively similar to any excess claim."¹¹⁹

Thus, the Supreme Court of Appeals of West Virginia applied contract principles to hold the insurer liable for consequential damages but did not apply the contract term setting forth the policy limits. Instead, the court applied third-party insurance bad faith law even though the insurer did not insure the tortfeasor but, instead, contracted with the injured party to provide coverage up to a specified amount if the tortfeasor was uninsured or underinsured. The insurer was required to pay the excess judgment even though it was not the insured who was subjected to a judgment in excess of the policy limits he had purchased but rather a tortfeasor who had purchased no insurance.¹²⁰

115. *Id.* (emphasis added).

116. *Id.*; accord *Morrison v. Haynes*, 452 S.E.2d 394 (W. Va. 1994).

117. *Marshall*, 450 S.E.2d at 797; accord *Morrison v. Haynes*, 452 S.E.2d 394 (W. Va. 1994).

118. *Marshall*, 450 S.E.2d at 798.

119. *Id.*

120. The *Marshall* Court also ruled that the circuit court had erred by entering judgment against the insurer for the excess verdict without holding a second trial to determine whether the insurer "was guilty of bad faith in failing to settle within its policy limits." *Id.* at 799.

Several months after the *Marshall* decision, the court in *Hadorn v. Shea*¹²¹ reaffirmed its holding concerning the application of *Hayseeds* in the uninsured/underinsured motorist insurance context. The *Hadorn* court also announced that *Marshall* had “by implication” extended *Hayseeds* to apply to all first-party insurance claims.¹²²

IV. EFFORTS TO EXTEND WEST VIRGINIA’S LAW OF INSURANCE BAD FAITH

As the foregoing demonstrates, West Virginia’s law of insurance bad faith has expanded dramatically in the last twenty years. Encouraged, perhaps, by these developments, plaintiffs across the state have attempted to gain recognition for novel causes of action that, if accepted, would significantly extend the principles adopted by the Supreme Court of Appeals of West Virginia to date. In particular, efforts have been made to create a new common law duty for insurers under third-party liability insurance policies. Third-party claimants have filed claims for breach of the common law duty of good faith and fair dealing against the insurers providing liability coverage to tortfeasors.

To date, the Supreme Court of Appeals of West Virginia has made clear that it has never approved this cause of action by third-party claimants against liability insurers. In *Charles v. State Farm Mutual Automobile Insurance Co.*,¹²³ the court pointed out that “no one has yet suggested that the purpose of the *Shamblin* doctrine is to protect victims.” However, dicta in the *Charles* opinion suggests that the “final contours” of West Virginia law have not yet been formed and that the court might consider an extension of the *Shamblin* doctrine to third-party claimants.¹²⁴ Accordingly, the remainder of this

121. 456 S.E.2d 194 (W. Va. 1995).

122. *Id.* at 196.

123. 452 S.E.2d 384, 389 (W. Va. 1994).

124. *Id.* Although some third-party claimants have alleged claims of breach of fiduciary duty against a tortfeasor’s insurer, the court has not suggested that such a duty could be owed by an insurer to a third-party claimant. Indeed, the court has stopped short of finding that an insurer has a formal fiduciary duty to an insured. In *Berry v. Nationwide Mutual Fire Insurance Co.*, the court’s opinion included a description of the insurer’s duty as merely “analogous to that of a fiduciary.” 381 S.E.2d 367, 373 n.6 (W. Va. 1989). It appears that *Berry*’s use of the word “analogous” was not accidental, but reflected that an insurer is

Article examines whether this proposal finds support in the existing law of West Virginia, whether an extension of West Virginia law would be consistent with the decisions of other states when presented with similar proposals, and whether such an extension would serve the goals underlying the Supreme Court of Appeals of West Virginia's bad faith jurisprudence.

A. West Virginia Caselaw Concerning the Scope of the Common Law Duty of Liability Insurers

As suggested by Charles, existing West Virginia law provides no support for the extension of the duty of good faith and fair dealing to third-party claimants. In fact, the pertinent cases formulate the implied covenant as existing only between the parties to the insurance contract. As the Supreme Court of Appeals of West Virginia has stated, every insurance policy in West Virginia contains "an implied covenant of good faith and fair dealing that neither party will do anything which will injure the right of the other to receive the benefits of the agreement."¹²⁵ Likewise, the *Shamblin* opinion referred to an insurer's duty

not a true fiduciary as defined by West Virginia law. In West Virginia, "a person acts as a fiduciary when the business he transacts, or the money or property he handles, is not for his benefit but for the benefit of another to whom he stands in confidence." *Koontz v. Long*, 384 S.E.2d 837, 839-40 (W. Va. 1989). An insurer, by contrast, is entitled to give its own interests consideration equal to that it gives the interests of its insured. *Berry*, 381 S.E.2d at 373 n.6. This fact would seem to distinguish the duties of an insurer toward its insured from those of a true fiduciary. West Virginia thus has not recognized a formal fiduciary duty between an insurer and its insureds, much less such a duty between an insurer and third-party claimants.

Other jurisdictions have decisively rejected the notion of placing upon liability insurers a fiduciary duty to third-party claimants. Recently, for instance, the Texas Supreme Court joined numerous other courts by concluding that creating such a duty would "necessarily compromise the duties the insurer owes their insured." *Transport Ins. Co. v. Faircloth*, 898 S.W.2d 269, 279 (Tex. 1995). The Texas court refused to require insurers "to perform duties for third-party claimants that are 'coextensive and conflicting' with that due to their own insureds." *Id.*; see also *Dimitroff v. State Farm Mut. Auto. Ins. Co.*, 647 N.E.2d 339 (Ind. Ct. App. 1995) (holding that no fiduciary duty exists between liability insurer and third-party claimant, even though claimant was also insured by same insurer under separate policy).

125. *Buckhannon-Upshur County Airport Auth. v. R & R Coal Contracting, Inc.*, 413 S.E.2d 404, 411 (W. Va. 1991) (quoting *Guin v. Ha*, 591 P.2d 1281, 1291 (Alaska 1979))

as running to *its insured*¹²⁶ and expressly described the rule announced therein as requiring “an aggressive good faith effort to settle and protect *its insured*.”¹²⁷ The court further stated that the *Shamblin* rule would be applicable “in future actions against insurers *by their insureds* for failure to settle third-party liability claims against them.”¹²⁸

The clarity of West Virginia law concerning the scope of the *Shamblin* duty was recognized in *Charles*, where the court observed that it was “beyond cavil” that the *Shamblin* doctrine “was created to protect *policyholders* who purchase insurance to safeguard their hard-won personal estates.”¹²⁹

The Supreme Court of Appeals of West Virginia’s limitation of the duty of good faith and fair dealing to policyholders is consistent with the theories underlying that duty. As *Charles* and *Shamblin* make clear, the duty arises because an insured purchases a policy to obtain protection from claims made by third parties. The insured typically surrenders to the insurer the right to control the defense and settlement of the litigation. In contrast, the third-party claimant has neither paid the insurer for policy protection nor given up any control over the litigation. Thus, the rationale for creating an implied covenant between an insurer and its insured does not apply to the relationship between an insurer and a third-party claimant — a stranger to the insurance contract.

B. *Decisions in Other Jurisdictions Concerning the Extension of the Common Law Duty for the Benefit of Third-Party Claimants*

Courts in other jurisdictions also have been asked to extend the duty of good faith and fair dealing to third-party claimants. They have overwhelmingly rejected such proposals.¹³⁰ Several reasons for this

(emphasis added).

126. *Shamblin*, 396 S.E.2d at 773-77.

127. *Id.* at 777 (emphasis added).

128. *Id.* at 775 (emphasis added).

129. *Charles*, 452 S.E.2d at 389 (emphasis added).

130. See *Hicks v. Alabama Pest Servs., Inc.*, 548 So. 2d 148, 150 (Ala. 1989); *Ring v.*

rejection commonly have been advanced.

These courts have emphasized that the duty of good faith and fair dealing implied in every insurance policy emanates from the insurer's obligation to act fairly in discharging its contractual responsibilities.¹³¹ Thus, these courts have reasoned, the implied covenant does not exist when there is no contractual relationship.¹³² Accordingly, these courts have held that there is no doctrinal basis for holding an insurer liable in tort to a third-party claimant as a stranger to the contractual relationship.¹³³

In addition, courts frequently have warned of the great practical difficulties that extending the implied covenant to third-party claimants

State Farm Mut. Auto. Ins. Co., 708 P.2d 457, 460-61 (Ariz. Ct. App. 1985); *Bell v. Kansas City Fire & Marine Ins. Co.*, 616 F. Supp. 1305, 1308-09 (W.D. Ark. 1985) (construing Arkansas and Oklahoma law); *Coleman v. Gulf Ins. Group*, 718 P.2d 77, 83-84 (Cal. 1986); *Schnacker v. State Farm Mut. Auto. Ins. Co.*, 843 P.2d 102, 104-05 (Colo. Ct. App. 1992); *Messina v. Nationwide Mut. Ins. Co.*, 998 F.2d 2, 5 (D.C. Cir. 1993) (applying District of Columbia law); *Allstate Ins. Co. v. Harris*, 211 S.E.2d 783, 785 (Ga. Ct. App. 1974); *Hettwer v. Farmers Ins. Co.*, 797 P.2d 81, 82 (Idaho 1990); *Scroggins v. Allstate Ins. Co.*, 393 N.E.2d 718, 721 (Ill. App. Ct. 1979); *Eichler v. Scott Pools, Inc.*, 513 N.E.2d 665, 667 (Ind. Ct. App. 1987); *Long v. McAllister*, 319 N.W.2d 256, 261-63 (Iowa 1982); *Bell v. Tilton*, 674 P.2d 468, 477 (Kan. 1983); *Linscott v. State Farm Mut. Auto. Ins. Co.*, 368 A.2d 1161, 1163-64 (Me. 1977); *Bean v. Allstate Ins. Co.*, 403 A.2d 793, 795-96 (Md. 1979); *Liimatta v. Lukkari*, 460 N.W.2d 251, 252 (Mich. Ct. App. 1990); *Nichols v. United States Fidelity & Guar. Co.*, 318 F. Supp. 334, 335-38 (N.D. Miss. 1970); *Santacruz v. United Pac. Ins. Co.*, 650 F. Supp. 32, 33-34 (D. Nev. 1986); *Duncan v. Lumbermen's Mut. Casualty Co.*, 23 A.2d 325, 326 (N.H. 1941); *Murray v. Allstate Ins. Co.*, 507 A.2d 247, 250-51 (N.J. Super. Ct. App. Div. 1986); *Browdy v. State-Wide Ins. Co.*, 289 N.Y.S.2d 711, 714 (N.Y. App. Div. 1968); *Dvorak v. American Family Mut. Ins. Co.*, 508 N.W.2d 329, 331-32 (N.D. 1993); *Murrell v. Williamsburg Local Sch. Dist.*, 634 N.E.2d 263, 265 (Ohio Ct. App. 1993); *Allstate Ins. Co. v. Amick*, 680 P.2d 362, 365 (Okla. 1984); *Auclair v. Nationwide Mut. Ins. Co.*, 505 A.2d 431, 431 (R.I. 1986); *Clark v. Hartford Accident & Indem. Co.*, 457 S.W.2d 35, 38 (Tenn. Ct. App. 1970); *Pixton v. State Farm Mut. Auto. Ins. Co.*, 809 P.2d 746, 748-51 (Utah Ct. App. 1991); *Tank v. State Farm Fire & Casualty Co.*, 715 P.2d 1133, 1139-41 (Wash. 1986); *Kranzush v. Badger State Mut. Casualty Co.*, 307 N.W.2d 256, 265 (Wis. 1981); *Herrig v. Herrig*, 844 P.2d 487, 491-92 (Wyo. 1992). *Contra* *Thompson v. Commercial Union Ins. Co.*, 250 So. 2d 259, 264 (Fla. 1971); *State v. District Court*, 703 P.2d 148, 158 (Mont. 1985).

131. See, e.g., *Dvorak*, 508 N.W.2d at 331.

132. See, e.g., *Messina*, 998 F.2d at 5.

133. *Id.*; *Galusha v. Farmers Ins. Exch.*, 844 F. Supp. 1401, 1403 (D. Colo. 1994); *Schnacker*, 843 P.2d 102, 104 (Colo. Ct. App. 1992); *Dvorak*, 508 N.W.2d at 331.

would create for liability insurers. Such courts have pointed out that the interests of the insured and the third-party claimant are often in conflict.¹³⁴ Accordingly, in the words of one court, “[w]hen faced with this issue, courts simply refuse to place an insurer in the untenable position of owing a duty of good faith and fair dealing to both the insured and the adversary of the insured.”¹³⁵

C. *Impact of Extending Shamblin to Third-Party Claimants Upon the Goals of West Virginia’s Bad Faith Jurisprudence*

As the foregoing demonstrates, the Supreme Court of Appeals of West Virginia has consciously created common law rules in the areas of first-party and third-party bad faith that are intended to ensure that policyholders are not deprived of the benefits they purchased. In the first-party context, the court has held that an insured who purchases a policy “buys insurance — not a lot of vexatious, time consuming, expensive litigation with his insurer.”¹³⁶ Similarly, in the third-party context, the court has insisted that policyholders “purchase insurance to safeguard their hard-won personal estates” and should not “find these estates needlessly at risk because of the intransigence of an insurance carrier.”¹³⁷ The court thus has consistently pursued the goal of ensuring that insurers observe a “very strong obligation of good faith to its insured.”¹³⁸

An extension of *Shamblin* to third-party claimants would serve an entirely different goal — to “protect” third-party claimants. Accordingly, one must ask whether such “protection” of third-party claimants is a worthy goal and, if so, whether the extension of the common law duty of good faith is the proper means of achieving this end. As discussed above, other jurisdictions have overwhelmingly answered both of these questions in the negative. They have concluded that third-

134. See, e.g., *O.K. Lumber v. Providence Washington Ins. Co.*, 759 P.2d 523, 525-26 (Alaska 1988).

135. *Herrig*, 844 P.2d at 491; see *Galusha*, 844 F. Supp. at 1404.

136. *Hayseeds*, 352 S.E.2d at 79.

137. *Shamblin*, 396 S.E.2d at 777.

138. *Id.* at 776.

party claimants, who have not paid for the insurance coverage in question and have not given up their right to control the litigation and settlement of their case, should not be granted rights against the liability insurer equal to those of the insured.¹³⁹ They also have held that extending “protection” to third-party claimants by means of the implied covenant is doctrinally insupportable.¹⁴⁰ The reasoning of these jurisdictions appears equally applicable to West Virginia, particularly in light of the Supreme Court of Appeals of West Virginia’s formulation of the implied covenant as running between parties to the insurance contract and its description of the duties that arise from the purchase of insurance and the insurer’s exclusive control over settlement negotiations on behalf of the insured.¹⁴¹ Moreover, as discussed below, the creation of the new cause of action would undermine key elements of the jurisprudence developed over the last twenty years in two ways.

1. Such Extension Would Compromise the Duty Owed to Policyholders

The extension of *Shamblin* would clearly carry with it an immense potential for harming the interests of policyholders. At first blush, it might be assumed that simply extending the duty of good faith and fair dealing to third-party claimants would not be a matter of concern to insureds because the formal legal rights of insureds would not be altered. This assumption, however, cannot withstand scrutiny. Once a third-party claimant raises an allegation that the insured acted wrongfully and demands compensation, it is a simple fact that the interests of the insured and the third-party claimant are likely to be in conflict. Furthering the interest of one party therefore entails a real danger of harming the interest of the other.

An insured, for example, may believe that the plaintiff’s claims are not warranted and may not want the case to be settled. Such a policyholder may reasonably want the case defended vigorously and may insist upon a “day in court” to vindicate his or her professional

139. See discussion *supra* Part IV.B.

140. *Id.*

141. See discussion *supra* Part IV.A.

or personal reputation.¹⁴² The third-party claimant, in contrast, may demand a settlement within policy limits and may claim that his or her interests would be injured if forced to proceed to trial. If an insurer under these circumstances were to settle the case in consideration of the interests of the third-party claimant, the insured might legitimately claim that his or her reputational interests had been seriously compromised.¹⁴³

Similarly, even in cases where reputational interests are not directly implicated, the policyholder might well have strong interests in not settling a claim that he or she believes is not warranted. These interests might arise from concerns about protecting his or her insurance record and/or keeping insurance premiums low. Once again, settlement in these circumstances in consideration of the interests of the third-party claimant would damage the interests of the policyholder.

Finally, even in circumstances where an insured favors settlement of the case, the extension of *Shamblin* would create serious concerns. The insured in these circumstances would have a reasonable interest in settling the case for as little money as possible, so that the remaining policy limits would not be unnecessarily exhausted and so that protection would still be available for other claims made against the insured.¹⁴⁴ The third-party claimant, on the other hand, would have an

142. Indeed, the insured's strong interest in litigating certain cases has traditionally been recognized in policies issued to doctors and other professionals. See ROWLAND H. LONG, THE LAW OF LIABILITY INSURANCE § 12.05 (1985) (pointing out that most medical liability insurance policies contain a requirement that the insured must consent to any settlement of claims).

143. This situation would be further complicated in cases where the insured files a counterclaim against the third-party claimant. The insurer's insistence on settlement in these circumstances obviously would create significant difficulties with respect to the insured's affirmative claims.

144. Depending on the type of coverage, policies can have both "per occurrence" and "aggregate" limits. For policies written on an occurrence basis, the "occurrence limit" is the "maximum amount that an insurance company is obligated to pay all insured parties seeking recourse as a result of the occurrence of an event covered under a liability insurance policy." HARVEY W. RUBIN, DICTIONARY OF INSURANCE TERMS 284-85 (2d ed. 1991). The "aggregate limit" is the "maximum dollar amount of coverage in force under a health insurance policy, a property damage policy, or a liability policy." *Id.* at 19. Once an insurer has paid the amount of the aggregate limit, the insured no longer has any coverage under that policy. If another claim arises that would otherwise be covered by that policy, the insured

interest in settling the case for the greatest possible amount. The most likely reconciliation of this conflict would be for the insurer to settle the case at a level that compromises the interests of both parties. Thus, even in the best of circumstances, the extension of *Shamblin* would require insurers to compromise the interests of their insureds. Such a result would be directly contrary to the Supreme Court of Appeals of West Virginia's desire to encourage insurers to engage in aggressive efforts to protect their insureds' interests. The extension of *Shamblin* would thus undermine one of the central principles espoused in West Virginia jurisprudence during the past two decades — that an insurer's primary duty is to observe “a very strong obligation of good faith to its insured.”¹⁴⁵

2. Such Extension Would Undermine the Cause of Action for Statutory Bad Faith

It also appears that the statutory cause of action established by *Jenkins* would be seriously affected by the extension of *Shamblin*. *Jenkins*, as discussed earlier, held that the West Virginia Legislature had created the statutory duty to settle for the benefit of third-party claimants (as well as insureds) and that an implied private cause of action was intended to enforce this duty.¹⁴⁶ The court also held that this legislation required plaintiffs to fulfill certain requirements, such as proving a “general business practice,” to prevail in such actions.¹⁴⁷ Creation of a *Shamblin* cause of action for third-party claimants would permit them to sue for essentially the same conduct prohibited by the unfair claim settlement practices statute, but would not require compliance with the various limitations that the Legislature has placed on such actions and that the Supreme Court of Appeals of West Virginia has emphasized over the last fifteen years. In effect, the extension of *Shamblin* thus would circumvent the requirements recognized in *Jenkins* and would render the statutory cause of action superfluous.

must pay the total amount of the loss.

145. *Shamblin*, 396 S.E.2d at 777.

146. See discussion *supra* Part III.A.2.

147. *Id.*

V. CONCLUSION

As discussed above, while West Virginia has, in many ways, led the nation in protecting both insureds and claimants, during the last twenty years, some of the decisions of the Supreme Court of Appeals of West Virginia appear to have unexpectedly frustrated the very goals the court sought to achieve. Accordingly, as the court reevaluates the law of insurance bad faith in West Virginia, it should consider clarifying some of its opinions.

Moreover, the court should reject any attempt to extend the insurer's duty of good faith and fair dealing to third-party claimants. There is no support for creating such a duty under West Virginia law and proposals for the recognition of such a duty have been overwhelmingly rejected in other jurisdictions across the nation. Furthermore, and perhaps most importantly, the extension of *Shamblin* to third-party claimants would seriously threaten the central goals that the court has pursued in its development of West Virginia's bad faith law over the past two decades — to ensure that policyholders are not deprived of the benefits they purchased and that insurers observe an obligation of good faith to their insureds.