

A NEW DAY IN NEW MEXICO FOR THIRD PARTY BAD FAITH CLAIMS

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New Mexico joined a handful of states when its Supreme Court held in *Hovet v. Allstate Ins. Co.*, 2004-NMSC-010, ___ N.M. ___, 89 P.3d 69, that a third party claimant has a “bad faith” private right of action against the insurer under the Unfair Claims Practices Act (UCPA).² The Court held that the Legislature intended to include claimants in the private right of action provided by § 59A-16-30 of the Insurance Code.³ The Court extended this right of action because it determined that the third party claimant is an “intended beneficiary” of the Mandatory Financial Responsibility Act (MFRA).⁴

Three steps set the stage for the *Hovet* holding. First, the legislature included a private right of action in its version of the National Association of Insurance Commissioners’ Model Act adopted by New Mexico in 1984.⁵ Subsequently, the New Mexico Supreme Court held in *Russell v. Protective Ins. Co.*, 107 N.M. 9, 751 P.2d 693 (1988), that a third party employee, as an intended beneficiary of the Workers’ Compensation Act (WCA), has a § 59A-16-30 private right of action for violations of the UCPA by an insurer providing insurance to his employer pursuant to the WCA. Third, the Court found that a third party claimant was an intended beneficiary of the Mandatory Financial Responsibility Act in *Raskob v. Sanchez*, 1998-NMSC-45, 126 N.M. 394, 970 P.2d 580.⁶

In its initial analysis of a third party right of action under the UCPA in *Russell*, the court reasoned that the Legislature intended to expand the “traditional notion of insured”⁷ to include those “who can demonstrate a special beneficiary status.”⁸ There, the Court found that the WCA was insurance mandated for the benefit of workers.⁹ Thus, the workers were intended beneficiaries of the contract between the insurer and employer pursuant to the WCA.¹⁰ “By virtue of being an intended beneficiary, the employee in *Russell* became a statutory ‘insured,’ to whom the insurer owed a duty of fair settlement practices as described in the Insurance Code.”¹¹

The legislature enacted § 59A-16-30 providing an express private cause of action in 1984 after two decisions in which the court had denied such relief to workers under the previous Insurance Code.¹² The *Russell* court found that this statute was a response to these decisions and indicated legislative intent to broaden the WCA by providing a separate bad faith tort action against insurers who refuse to pay compensation benefits.¹³ The *Russell* decision was ultimately abrogated by the legislature’s provision of a bad faith or unfair claims settlement remedy within the WCA.¹⁴

The Court in *Hovet* relied on *Raskob* to establish third party claimants as intended beneficiaries of the MFRA.¹⁵ *Raskob*’s holding rested on the finding that compulsory liability insurance “is intended to provide a benefit to the general public.”¹⁶ The majority in *Hovet* combined the rationales of *Raskob* and *Russell* in arriving at its decision to provide a third party action despite failed legislative efforts to include an explicit third party right of action and other evidence of legislative intent to the contrary.¹⁷ *Raskob* provided authority for a third party to join an insurer in a lawsuit yet left open the question of relief. *Hovet* provides relief for a third party claimant against an insurer yet it denies joinder in the action for relief.

The *Hovet* court felt compelled to interpret the UCPA and private right of action broadly because the *Russell* decision did not limit its holding to the WCA.¹⁸ To achieve the statute’s remedial purposes, the court read the UCPA as a whole to find legislative intent.¹⁹ It determined that legislative intent was to create a remedy for both insureds and third party claimants in order to encourage ethical claims practices within the insurance industry.²⁰

Justice Frye’s dissent in *Hovet* strongly refutes the reasoning used by the majority to reach its decision. First, J. Frye declares that the Insurance Code “cannot be read to impose on insurers a duty to third-party claimants that is equal to the duty insurers owe their insureds.”²¹ By reading the Insurance Code to compel such a duty, the majority is creating law – imposing its “own notions of policy on the statutory language.”²²

She reminds the Court that statutes creating rights contrary to common law must be interpreted with restraint.²³

The dissent pointedly parses the statute by analyzing individual subsections that distinguish between “claimants” and “insureds.”²⁴ The Legislature uses the terms “claimants” or “beneficiaries” in only three out of fifteen subsections.²⁵ Construing the statute as a whole to find legislative intent ignores this express distinction made by the Legislature. This careful distinction is an indication of legislative intent to treat claimants and insureds differently.²⁶

J. Frey also questions the role of *stare decisis* and the decision in *Russell* relied upon by the majority. The narrow question decided by the court in *Russell* involved the relationship of the third party action to the WCA. Because the question in *Hovet* concerned the MFRA, *Russell* was inapplicable and use of that decision was contrary to the established principle that “cases are not authority for propositions not considered.”²⁷

The dissent questions the wisdom of using the policies of the MFRA to interpret the Insurance Code when the plain language of the Insurance Code distinguishes between claimants and insured.²⁸ Finally, J. Frey points to other existing safeguards to promote fair settlement practices.²⁹

In *Moradi-Shalal v. Fireman’s Fund Insurance Cos.*, 758 P.2d 58 (Cal. 1988), the California Supreme Court reversed its initial decision granting third parties a statutory bad faith cause of action. There, the court listed social, economic and judicial problems encountered in the nine years since creating the private right of action in *Royal Globe Ins. Co. v. Superior Court*, 592 P.2d 329 (Cal. 1979). Problems included coercion of inflated settlements, excessive jury awards and attorney fees, and, in response, escalating insurance costs to the public.³⁰

The California courts encountered analytical problems in attempts to apply the *Royal Globe* holding. Courts were unclear about how to determine when the insurer’s duty to settle arises and whether mutual good faith obligations are imposed on third party claimants as well.³¹ A conflict of interest for the insurer was inherent – how to balance the interest of the insured with the interest in the insurer in avoiding third party claims.³²

The *Hovet* court recognized the problems encountered in California. It imposed several limitations on the third party right of action to address these problems. First, the Court noted the “special, if not unique place” held by mandatory automobile liability insurance. It expressly stated that this holding applied only to the MFRA.³³ Second, the Court limited availability of the action; a claim may be filed only after the conclusion of underlying negligence litigation in which there has been a judicial determination of fault against the insured and damages awarded to the claimant.³⁴ Thus, the insured and insurer cannot be sued in the same lawsuit.³⁵ Moreover, settlement will waive any claim to a third party action.³⁶ Third, defense attorneys may not be named as defendants in an action brought under the UCPA.³⁷ This limitation, coupled with the precondition of a prior judicial determination of liability, might preclude some personal conflict of interest problems for attorneys. For example, attorneys would not be compelled to appear as witnesses in their own cases.³⁸ However, it does not address the conflict of interest that remains for the insurer.

It remains to be seen whether and to what extent these limitations will solve the problems noted by the California court. It may be that the requirement of a final judgment in favor of the claimant and precluding actions after settlement will restrain the number of cases filed. However, the probability that more insurers will settle more quickly could lead to a rise in insurance costs to the public. This same tendency to settle more quickly may create a conflict of interest between the insurer and the insured, potentially weakening an insurer’s resolve to fulfill its duty to defend.³⁹

Finally, the Court declines to rule on whether punitive damages are available.⁴⁰ With a reminder that they are recognizing a statutory right of action as opposed to a common law bad faith right of action, the Court notes the Insurance Code does not expressly provide for punitive damages.⁴¹ A hint, perhaps, that the Court might decline to find punitive damages available.

The importance of the *Hovet* decision may diminish as the importance of both the *Russell* and *Raskob* decisions declined in the face of legislative action and judicial containment. As discussed earlier, the *Russell* decision was addressed by legislative action incorporating a “bad faith” remedy in the WCA. The danger of disclosing the existence of an insurer to the jury inherent in the joinder made possible by *Raskob* was limited by the subsequent decision in *Martinez v. Reid*, 2002-NMSC-15, 132 N.M. 237, 46 P.3d 1237. There, the Court provided for bifurcation.

Romero v. Pueblo of Sandia/Sandia Casino, 2003-NMCA-137, 134 N.M. 553, 80 P.3d 490, provides a window into possible extensions of the *Hovet* holding. The court in *Romero* extended *Raskob* beyond cases invoking the MFRA and allowed joinder of the Pueblo’s insurer for personal injury liability insurance mandated by the Pueblo’s state gaming Compact.⁴² The court there found that the Compact was entered into for the benefit of the public.⁴³ An injured visitor to the casino was, as a member of the public, an intended beneficiary of the Compact. Thus, the insurer was subject to joinder in a negligence action against the insured.

Already, third party claimants are relying on *Hovet* to bring bad faith actions against automobile insurers. The class action, *Martinez v. Allstate I*, No. D-101-CV-200400963 (N.M. 1st Jud. Dist. filed May 12, 2004), alleges, *inter alia*, violations of § 59A-16-20(E) and (G) of the UCPA.⁴⁴ Plaintiffs allege that Allstate’s blanket application of various corporate practices, designed to “increase corporate profits by systematically reducing claim payments,” established a general business practice in violation of the UCPA.⁴⁵ Plaintiffs request actual damages, compensatory damages and punitive damages as well as attorney fees.

Issues likely to be raised in *Martinez v. Allstate* may enable the New Mexico Supreme Court to refine its holding in *Hovet*. If not, it is likely New Mexico courts will have many other opportunities to do so.

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² NMSA 1978, § 59A-16-20 (1984). Other jurisdictions that have recognized a third party statutory cause of action include Montana (*Klaudt v. Flink*, 658 P.2d 1065 (Mont. 1983), *superseded by statute as stated in O’Fallon v. Farmers Ins. Exchange*, 859 P.2d 1008 (Mont. 1993); *see also* Mont. Code Ann. § 33-18-242 (1987)), West Virginia (*Jenkins v. J.C. Penney Casualty Ins. Co.*, 280 S.E.2d 252 (W. Va. 1981), *overruled in part on other grounds, State ex rel. State Farm Fire & Casualty Co. v. Madden*, 451 S.E.2d 721 (1994)), Kentucky (*State Farm Mutual Automobile Ins. Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1988), Massachusetts (*Hopkins v. Liberty Mut. Ins. Co.*, 750 N.E.2d 943, 950, n.12 (Mass. 2001); *see also* Mass. Gen. Laws Ann. Ch. 193A, § 9 (YR?), ch. 176D § 3 (YR?)).

³ NMSA 1978, § 59A-16-30 (1984) provides a private right of action to “[a]ny person covered by Chapter 59A, Article 16 NMSA 1978 who has suffered damages as a result of a violation of that article by an insurer or agent[.]”

⁴ *Hovet*, 2004-NMSC-010, ¶ 17, ___ N.M. ___, 89 P.3d at 74.

⁵ Previously, there was no private cause of action available for insureds or third party claimants.

⁶ *Raskob v. Sanchez*, 1998-NMSC-45, 126 N.M. 394, 970 P.2d 580 (holding injured can join insurer in action against insured under the MFRA).

⁷ *Russell*, 107 N.M. at 13, 751 P.2d at 697.

⁸ *Hovet*, 2004-NMSC-010, ¶ 16-17, ___ N.M. ___, 89 P.3d at 74. The Court quotes *Russell*: “the legislature ... intended to expand that [traditional] notion [of insured] to parties other than those who may have signed a written contract of insurance beneath a blank reading ‘insured.’” *Id.* ¶ 17, ___ N.M. at ___, 89 P.3d at 74 (quoting *Russell*, 107 N.M. at 13, 751 P.2d at 697).

⁹ 107 N.M. at 13, 751 P.2d at 697.

¹⁰ *Id.* at 14, 751 P.2d at 698.

¹¹ *Hovet*, 2004-NMSC-010, ¶ 16, ___ N.M. ___, 89 P.3d at 74.

¹² *Russell*, 107 N.M. at 10-11, 751 P.2d at 694-95. See also *Dickson v. Mountain States Mut. Casualty Co.*, 98 N.M. 479, 650 P.2d 1 (1982); *Gonzales v. U.S. Fidelity & Guar. Co.*, 99 N.M. 432, 659 P.2d 318 (Ct. App. 1983). The previous Insurance Code did not include a private right of action.

¹³ *Russell*, 107 N.M. at 12, 751 P.2d at 696.

¹⁴ *Cruz v. Liberty Mut. Ins. Co.*, 119 N.M. 301, 303, 889 P.2d 1224, 1225 (1995) (stating that WCA provides exclusive remedy for employee third party actions under the UCPA); see also NMSA 1978, § 52-1-28.1 (1990). The *Russell* decision might have been different had the bad faith remedy already been provided in the WCA. It is not clear that the legislature acted in response to *Russell*. It is likely that the bad faith provision was enacted to preserve the exclusivity of the WCA. It is, however, ironic that the Court is expanding *Russell* when *Russell* is no longer an available remedy.

¹⁵ *Hovet*, 2004-NMSC-010, ¶ 19, ___ N.M. ___, 89 P.3d at 75; see also *supra*, n.4.

¹⁶ 1998-NMSC-45, ¶ 6, 126 N.M. at 395, 970 P.2d at 581.

¹⁷ See H.B. 314, 44th Leg., 1st Sess. (N.M. 1999); See also NMSA 1978 § 59A-16-20(J), (K), and (L) (1984, as amended in 1993).

¹⁸ *Hovet*, 2004-NMSC-010, ¶ 17, ___ N.M. ___, 89 P.3d at 74.

¹⁹ *Hovet*, 2004-NMSC-010, ¶¶ 14, 17, ___ N.M. ___, 89 P.3d at 73-74.

²⁰ *Id.*

²¹ *Id.* ¶ 33, ___ N.M. at ___, 89 P.3d at 78.

²² *Id.* ¶ 34, ___ N.M. at ___, 89 P.3d at 78.

²³ *Id.*

²⁴ *Id.* ¶ 35, ___ N.M. at ___, 89 P.3d at 79.

²⁵ § 59A-16-20(J), (K), and (L).

²⁶ *Hovet*, 2004-NMSC-010, ¶ 35, ___ N.M. at ___, 89 P.3d at 79.

²⁷ *Id.* ¶ 39, ___ N.M. at ___, 89 P.3d at 79-80 (citations omitted).

²⁸ *Id.* ¶ 40, ___ N.M. at ___, 89 P.3d at 80.

²⁹ *Id.* ¶ 41, ___ N.M. at ___, 89 P.3d at 80. Rule 1-068 NMRA 2004 provides payment of claimants costs and prejudgment interest is available pursuant to NMSA 1978, § 56-8-4(B) (1993). Administrative action is provided in NMSA 1978, § 59A-5-26(C)(2)(a) (1984).

³⁰ *Moradi-Shalal*, 758 P.2d at 66.

³¹ *Id.* at 67.

³² *Id.*

³³ *Hovet*, 2004-NMSC-010, ¶ 24, ___ N.M. ___, 89 P.3d at 76. The Court noted other statutes mandating liability insurance in New Mexico: NMSA 1978, §§ 47-7C-13 (1982) (mandating liability insurance for condominium associations), 56-6-5 (1953) (mandating insurance for agricultural warehousemen), 24-15-2 (1997) (mandating insurance for ski lift and tramway operators), 57-25-3 (1996) (mandating insurance for carnival operators), 58-1-67(B) (1963) (mandating insurance for banks “against burglary, robbery, theft and other similar insurable hazards”). *Hovet*, 2004-NMSC-010, ¶ 24, n.4, ___ N.M. ___, 89 P.3d at 76.

³⁴ *Hovet*, 2004-NMSC-010, ¶¶ 25-26, ___ N.M. ___, 89 P.3d at 76-77.

³⁵ *Compare Raskob*, 1998-NMSC-45, 126 N.M. 394, 970 P.2d 580 (holding injured can join insurer in action against insured under the MFRA).

³⁶ *Hovet*, 2004-NMSC-010, ¶ 26, ___ N.M. at ___, 89 P.3d at 76.

³⁷ *Id.* ¶ 27, ___ N.M. at ___, 889 P.3d at 77.

³⁸ *Id.*

³⁹ See 18 ALR 5th 474 (1994).

⁴⁰ *Id.* ¶ 28, ___ N.M. at ___, 889 P.3d at 77.

⁴¹ *Id.*

⁴² *Romero*, 2003-NMCA-137, ¶ 3, 134 N.M. at 554, 80 P.3d at 491.

⁴³ *Id.* ¶ 10, 134 N.M. at 556, 80 P.3d at 493.

⁴⁴ NMSA 1978, § 59A-16-20(E) (1984) (“not attempting in good faith to effectuate prompt, fair and equitable settlements); NMSA 1978, § 59A-16-20(G) (1984) (“compelling insureds to institute litigation to recover amounts due by offering substantially less than the amounts ultimately recovered ... when such insureds have made claims for amounts reasonably similar to amounts ultimately recovered”)

⁴⁵ See *Martinez Complaint*, ¶ 15.