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FIGHTING FIRE WITH FIRE: "REVERSE BAD FAITH" IN FIRST-PARTY LITIGATION INVOLVING ARSON AND INSURANCE FRAUD

CATHRYN M. LITTLE†

In the context of first-party insurance litigation, the concept of "reverse bad faith" refers to a cause of action allowing an insurer to assert a counterclaim for affirmative relief against an insured who brings a frivolous, bad faith action.¹ Bad faith litigation by an insured against an insurer has long been recognized under certain circumstances.² For example, a bad faith refusal by an insurer to provide insurance coverage or to pay a justifiable claim may give rise to a claim for punitive damages.³ In general,

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2. See supra note 1.

3. In North Carolina, although punitive damages are generally not recoverable for breach of contract, except for a breach of a contract to marry, Miller v. Nationwide Mut. Ins. Co., 112 N.C. App. 295, 306, 435 S.E.2d 537, 544 (1993), punitive damages may be available when the breach is accompanied by identifiable tortious conduct and by some element of aggravation. Dailey v. Integon Gen. Ins. Corp., 57 N.C. App. 346, 291 S.E.2d 331 (1982), appeal after remand, 75 N.C. App. 387, 331 S.E.2d 148, disc. review denied, 314 N.C. 664, 336 S.E.2d 399 (1985) (reinstating a punitive damages award against an insurance company). Where an insured has alleged that an insurer has acted in bad faith accompanied by willful and malicious conduct, and such allegations are supported by specific examples, the insured may have sufficiently alleged a tortious act if accompanied by the requisite element of "aggravation." Miller, 112
an action for reverse bad faith should be recognized where: (1) an
insured owes his insurer a duty to act in good faith; (2) the insured
in bad faith acts, or fails to act; (3) such bad faith act, or failure to
act, by the insured interferes with the insurer's adjustment, inves-
tigation, defense, or settlement of a claim; and (4) the insurer is
prejudiced by the insured's bad faith conduct.4

I. WHAT DECISIONS HAVE INDICATED A WILLINGNESS TO
RECOGNIZE A CAUSE OF ACTION FOR REVERSE BAD
FAITH AND FOR WHAT REASONS?

Although legal scholars have addressed arguments both for
and against the adoption of a cause of action for reverse bad faith,5

N.C. App. at 306, 435 S.E.2d at 544. See also Dailey, 57 N.C. App. 346, 291
App. 692, 313 S.E.2d 912 (1984). "Aggravation" has been "defined to include
fraud, malice, such a degree of negligence as indicates a reckless indifference to
plaintiff's rights, oppression, insult, rudeness, caprice, and willfulness." Newton
facts and allegations in the insured's complaint must be sufficient to prevent
confusion and surprise to the insurer, but will preclude recovery of punitive
damages for breach of contract where tortious conduct does not accompany the
breach. Shugar v. Guill, 304 N.C. 332, 283 S.E.2d 507 (1981). It is for the trier of
case to determine whether the alleged facts rise to the level of aggravated conduct
necessary to support a claim for punitive damages. Miller, 112 N.C. App. at 306,
(1990)).

4. See William S. Anderson, Placing a Check on an Insured's Bad Faith
Conduct: The Defense of "Comparative Bad Faith," 35 S. TEX. L. REV. 485, 528
(1994). See also Douglas R. Richmond, Insured's Bad Faith as Shield or Sword:
Litigation Relief for Insurers?, 77 MARQ. L. REV. 41, 69 (citing George H. Mitchell &
Christopher Robbins, Comparative Bad Faith: "Reverse Bad Faith." When
Should You Make a Claim Against Your Own Insured?, Insurance Claims
E-24) (arguing that, "an insurer should be able to assert a first-party bad faith
claim against an insured if: (1) the insured knowingly withholds relevant
evidence from the insurer, fabricates or falsifies evidence, or engages in other
fraudulent conduct; or (2) the insured sues the insurer for bad faith without
probable cause, to gain an unfair economic advantage, or for the purpose of
coeering the carrier to pay a disputed claim.").

5. See Douglas R. Richmond, An Overview of Insurance Bad Faith Law and
Litigation, 25 SETON HALL L. REV. 74 (1994); Richmond, supra note 4; Anderson,
supra note 4; Patrick E. Shipstead & Scott S. Thomas, Comparative and Reverse
Bad Faith: Insured's Breach of Implied Covenant of Good Faith and Fair Dealing
as Affirmative Defense or Counterclaim, 23 TORT & INS. L.J. 215 (1987); John F.
to date the number of published decisions applying or citing the specific term "reverse bad faith" are relatively few.6


6. As of the date of research for this article, a Westlaw search using the term "reverse bad faith" reveals the following cases: Parker v. D'Avolio, 664 N.E.2d 858, 864 (Mass. App. Ct. 1996) (addressing the concept of reverse bad faith in an action against a landlord for lead poisoning, and noting, "[i]n deed, case law suggests, in the context of insurance claims, that courts be vigilant to ensure that plaintiffs not engage in 'reverse bad faith' conduct"); Johnson v. Farm Bureau Mut. Ins. Co., 533 N.W.2d 203, 208 (Iowa 1995) (denying to adopt a tort of reverse bad faith under Iowa law); Hanna v. Fleetguard, Inc., 900 F. Supp. 1110, 1123, 1129 (N.D. Iowa 1995) (denying plaintiff's motion to remand case to state court on the grounds that her bad faith claims against her former employer and its workers' compensation carrier did not arise under the Iowa workers' compensation statute, and footnoting that Johnson, 533 N.W.2d at 208, had rejected recognition of a claim for reverse bad faith under Iowa law); Reedy v. White Consol. Indus., Inc., 890 F. Supp. 1417, 1435 (N.D. Iowa 1995) (denying employer's motion for summary judgment on former employee's claims, including bad faith termination of workers' compensation benefits, and footnoting Johnson's, 533 N.W.2d 203, rejection of a claim for reverse bad faith under Iowa law); Snap-on Tools Corp. v. First State Ins. Co., No. 91-1356, 1993 WL 91563, at *13, *26-27 (Wis. Ct. App., Mar 31, 1993) (Unpublished Disposition) (after a jury found an insured company acted in bad faith and awarded its insurer $250,000 in compensatory damages and $4,000,000 in punitive damages, the Wisconsin Court of Appeals found the trial court had committed reversible error in refusing the insurer's motion for summary judgment because the liability insurance policy did not provide coverage for the underlying claim, and refused to consider whether Wisconsin law recognizes a cause of action for reverse bad faith because the insurer did not assert its counterclaim until after the trial court had improperly refused the summary judgment motion); Tokles & Son, Inc. v. Midwestern Indem. Co., 605 N.E.2d 936, 945 (Ohio 1992) (refusing to recognize the tort of reverse bad faith under Ohio law); Tokles & Son, Inc. v. Midwestern Indem. Co., No. L-89-395, 1991 WL 355145 (Ohio Ct. App. Sep. 13, 1991) (finding that Ohio law does not impose upon an insured a duty to act in good faith in filing, processing or litigating an insurance claim, the breach of which will give rise to a cause of action for breach of that duty); Andrew Jackson Life Ins. Co. v. Williams, 566 So. 2d 1172, 1190 (Miss. 1990) (affirming jury's award against insurer of $28,000 in compensatory damages and $200,000 in punitive damages where the record was "replete with evidence evincing bad faith-plus" by the insurer); Cooper v. Equity Gen. Ins., 268 Cal. Rptr. 2d 692 (Cal. Dist. Ct. App. 1990) (affirming the trial court's dismissal of an insurer's amended cross-complaint which was demurred in part on the grounds that there was no legal basis for recovery of damages in a reverse bad faith claim); Handal v. U.S. Fidelity and Guar. Co., 237 Cal. Rptr. 2d 667, 674 (Cal. Dist. Ct. App. 1987) (recognizing that "a duty of good faith and fair dealing in an insurance policy is a two-way street, running from the insured to his insurer as well as vice versa. . . . " [citations omitted] and that "reciprocal duty has been deemed sufficient in an
During its relatively limited history, the concept of "reverse bad faith" has followed a serpentine path which varies among the jurisdictions which have addressed the issue.\(^7\) To date, the limited number of jurisdictions which have directly addressed the issue in published decisions have declined to recognize it as a cause of action.\(^8\) Of the two jurisdictions, Iowa and Ohio, which have directly addressed the issue and refused to recognize an action for reverse bad faith against an insured under the law of their respective states, the reasons cited include: (1) "the insured, who often finds himself in dire financial straits after the loss, must have the equal footing which is provided by the ability to sue the insurer for bad faith;"\(^9\) (2) the insurer drafted the policy and can refuse the insured's claim;\(^10\) (3) there are other avenues for the insurer to appropriate case to support the insurer's affirmative defense of comparative bad faith in an action brought by the insured."). The court relied on California Casualty Gen. Ins. Co. v. Superior Court, 218 Cal. Rptr. 2d 817, 822-23 (1985) (which held that the doctrine of comparative fault should apply in bad faith cases, reasoning that, "in an appropriate case, an insured's breach of the implied duty of good faith and fair dealing, which contributes to an insurer's failure to pursue or delay in pursuing the investigation and payment of a claim may constitute at least a partial defense to the plaintiff's damage action for the insurer's breach of its duty of good faith and fair dealing based on such delay or failure").


8. See, e.g., Johnson, 533 N.W.2d at 208; Tokles, 605 N.E.2d at 945. Several jurisdictions have addressed the application of concepts of "comparative bad faith" and "comparative fault." These may provide an insurer with a defense to a bad faith action based upon an insured's comparative bad faith, but would not provide an insurer an affirmative right of recovery against an insured for damages suffered by the insurer as a result of the insured's bad faith. For a discussion of the concepts of comparative fault, comparative bad faith, and cases addressing the same, and how they differ from the concept of reverse bad faith, see, e.g., Anderson, supra note 4, at 528-33; Richmond, supra note 5. For additional discussion regarding the application of "comparative bad faith" as a defense based upon comparative fault by an insured, as opposed to affirmative attempts by an insurer to recover on a counterclaim for reverse bad faith, see, e.g., Ellen Smith Pryor, Comparative Fault and Insurance Bad Faith, 72 Tex. L. Rev. 1505 (1994), and authorities cited therein.

9. Tokles, 605 N.E.2d at 945.
10. Id.
pursue in the event that an insured submits a fraudulent claim, including a cause of action against the insured for fraud;\textsuperscript{11} and (4) the insurer can have an adequate remedy against an insured who files a frivolous bad faith claim under a state rule of civil procedure allowing sanctions.\textsuperscript{12}

Each of the above points invites more persuasive counter-arguments, particularly in the context of arson and fraud cases. There are at least\textsuperscript{13} ten arguments in favor of allowing an insurer a cause of action for reverse bad faith in first-party actions.

First, an insured who commits arson or fraud often would not be in such severe "financial straits" if he had not committed the tortious acts in an attempt to profit from his own wrongdoing.

Second, the fact that an insurer may generally be perceived to occupy a superior financial position should not tip the scales in an insured's favor on the issue of reverse bad faith. The matters to be addressed concern fraud and wrongful conduct, which are factually and legally irrelevant and immaterial to the issue of relative bargaining strength.\textsuperscript{14}

Third, an insurer's purpose in drafting an insurance policy with express exclusions for wrongful acts of an insured, such as intentional burning and material misrepresentation, is to exclude coverage for such acts and prevent the insured from trying to profit under the policy from his own wrongdoing.

Fourth, the fact that an insurer drafted the policy should not render it incapable of asserting a reverse bad faith claim against an insured under the premise that an insurance policy is viewed as an "adhesion contract." The act of an insured which gives rise to a reverse bad faith claim is the breach of the duty of good faith. Good faith is implied by law, and does not directly concern any clause in the policy which an insured would not have agreed to if he had equal bargaining power.\textsuperscript{15}

Fifth, although an insurer may be able to assert other causes of action under state law against an insured, such as fraud or

\textsuperscript{11} Id.
\textsuperscript{12} Johnson, 533 N.W.2d at 208.
\textsuperscript{13} See supra note 3 for additional arguments.
\textsuperscript{14} For additional discussion regarding courts' assumptions that insurers occupy a superior financial position, see, e.g., Richmond, supra note 5, at 136.
\textsuperscript{15} For further discussion concerning courts' perceptions that insurance policies are "adhesion contracts" under which the parties have unequal bargaining power, see, e.g., Richmond, supra note 5, 25 Seton Hall L. Rev. at 137 (citing Richmond, supra note 4, at 67, and citing Dobbyn, supra note 5, at 372).
breach of contract, limiting an insurer to such causes of action would not afford the insurer an opportunity to seek affirmative relief for independently actionable bad faith allegations made by the insured, which should be considered to be compulsory counterclaims in a bad faith action by an insured.

Sixth, if an insurer were precluded from pursuing a compulsory counterclaim that other litigants in the same position would be able to assert, it would unfairly deny the insurer a legitimate avenue of recovery under the law simply because it is in the business of insurance. 16

Seventh, requiring any causes of action under state law against the insured, such as fraud or breach of contract, to be pursued by an insurer in a separate action is contrary to the interests of judicial economy and places an undue burden and increased financial and time demands upon courts, insurers and insureds. 17

Eighth, sanctions under state rules of civil procedure are customarily awarded against a party's attorney, rather than a party himself. Moreover, courts rarely award sanctions for the full amount of a party's damages, costs and expenses, including attorney's fees. It is unlikely that an insurer could be made whole with an award of sanctions without allowing it to pursue an affirmative counterclaim to recover the full amount of its damages suffered as a result of the insured's bad faith.

Ninth, if insureds are allowed free reign in pursuing frivolous bad faith actions against insurers, without any threat that they will be potentially liable in tort for unjustified and baseless

16. For the observation that previous courts' rejections of a cause of action for reverse bad faith deprive insurers of a potential compulsory counterclaim for no reason other than the nature of their business, see, e.g., Richmond, supra note 5, 25 SETON HALL L. REV. 74, at 136 (citing Richmond, supra note 4, at 66). But see also Kallianos, supra note 1, at 1427-28 (recognizing that because the insurance industry is affected with a public interest and is frequently regarded as quasi-public in nature, insurers are often compared to common carriers and public utilities and are not treated like ordinary commercial businesses but are deemed to have additional obligations as quasi-public entities and their conduct has been subject to strict scrutiny by the judiciary).

17. For additional commentary that any judicial preference for more than one action would unnecessarily burden courts and litigants, see, e.g., Richmond, supra note 5, 25 SETON HALL L. REV. at 136 (citing Richmond, supra note 4, at 66). See also Dobbyn, supra note 5, at 379 (criticizing courts' historic protection of all insureds and observing, "until those same courts are willing to recognize that commercial and industrial insureds do not fit within the stereotype of 'sailors, idiots and infants,' there is scarcely a chance that the law will deal even-handedly with the two parties to insurance contracts").
claims, there is no reason why first-party actions would not routinely be accompanied by bad faith claims against insurers, whether or not they are justified.

Tenth, there is little chance that insurers will abuse the system if a cause of action for reverse bad faith is recognized. Insurers, ever mindful of the economic bottom line, are unlikely to go to the increased time, trouble and expense of seeking affirmative relief unless they have a sufficiently strong case to justify the same, particularly in light of the fact that courts and juries historically tend to favor insureds rather than insurers. 18

A. Discussion of Published Decisions Which Do Not Specifically Address a Cause of Action for "Reverse Bad Faith," But Which Provide Persuasive Reasons Why the Concept Should be Applied in First-Party Bad Faith Insurance Litigation

Certain published decisions, which do not specifically address the propriety of allowing a cause of action for reverse bad faith, nevertheless provide compelling reasons why the concept of reverse bad faith should be applied in first-party 19 bad faith insurance litigation. 20 This is particularly true in the context of intentional wrongful acts committed by an insured, including

18. For additional observations concerning the traditional preference by courts and juries in favor of insureds, see, e.g., Richmond, supra note 5, 77 MARQ. L. REV. at 68, observing that, "[c]ourts' and juries' perception of insured Davids versus insurer Goliaths will probably not fade any time soon." See also Dobbyn, supra note 5, at 379.

19. For a discussion of arguments in favor of allowing insurers a cause of action for reverse bad faith in third-party cases, see Richmond, supra note 4, at 62-63, 68; see also Dobbyn, supra note 5 (suggesting that a cause of action by an insurer against an insured is appropriate where an insured's bad faith hindrance of a settlement ultimately exposes the insurer to increased liability).

20. See, e.g., Gendreau v. Foremost Ins. Co., 423 N.W.2d 712, 714 (Minn. Ct. App. 1988) (affirming award of attorney's fees on insurer's counterclaim against insured based upon state statute allowing attorney's fees against a party who has acted in bad faith, but without specifically addressing the term "reverse bad faith"). See also RSBI Aerospace, Inc. v. Affiliated FM Ins. Co., 49 F.3d 399 (8th Cir. 1995) (affirming trial court's entry of summary judgment for insurer on insured's bad faith claim in employee arson case, but denying summary judgment on insurer's counterclaim for expenses incurred in investigation and defense of action, without addressing the propriety of the insurer's counterclaim); Twin City Fire Ins. Co. v. Country Mut. Ins. Co., 23 F.3d 1175, 1180 (7th Cir. 1994) ("[D]uty of good faith between insured and insurer is a reciprocal one . . .").
intentional burning, frequently referred to as arson,\textsuperscript{21} and material misrepresentation, commonly referred to as fraud.\textsuperscript{22}

In *Gendreau v. Foremost Insurance Co.*,\textsuperscript{23} the insurer provided fire insurance for the insured’s trailer and its contents. The insurance contract contained an exclusion for coverage if the insured provided false information to the insurer with the intent

\begin{quote}
21. Although insurance claims which are denied based upon an insured’s intentional burning of his property are commonly referred to as “arson” cases, they are more correctly referred to as “intentional burning” cases. This is true because the language of insurance contracts and statutory standard fire insurance policies in effect in many states, including North Carolina, usually contains exclusions based upon an insured’s direct or indirect participation in the “intentional burning” of the insured property. The central themes behind a civil “arson” defense in insurance litigation are similar to those involved in a criminal arson prosecution. Both require a certain degree of evidence to prove that someone intentionally burned the property in question. However, civil and criminal cases have different elements of proof, different burdens of proof, and different concerns regarding “who done it.” In North Carolina, in order to establish the defense of intentional burning by an insured in a civil action, an insurer must prove by a preponderance of the evidence that the insured: (1) participated directly or indirectly (2) in the intentional burning of the insured property. Freeman v. St. Paul Fire and Marine Ins. Co., 72 N.C. App. 292, 299, 324 S.E.2d 307, 311, cert. denied, 313 N.C. 599, 330 S.E.2d 609 (1985). North Carolina criminal statutes prohibiting wrongful burning of real and personal property include, but are not limited to, the following:

\textbf{§14-65. Fraudulently Setting Fire to Dwelling Houses.}

If any person, being the occupant of any building used as a dwelling house, whether such person be the owner thereof or not, or, being the owner of any building designed or intended as a dwelling house, shall wantonly and willfully or for a fraudulent purpose set fire to or burn or cause to be burned, or aid, counsel or procure the burning of such building, he shall be punished as a Class H felon.

\textbf{§14-66. Burning of Personal Property.}

If any person shall wantonly and willfully set fire to or burn, or cause to be burned, or aid, counsel or procure the burning of, any goods, wares, merchandise or other chattels or personal property of any kind, whether or not the same shall be insured by any person or corporation against loss or damage by fire, with intent to injure or prejudice the insurer, the creditor or the person owning the property, or any other person, whether the property is that of such person or another, he shall be punished as a Class H felon.


22. Insurance claims which are denied on the basis of material misrepresentation by an insured are often referred to as “insurance fraud” cases. Many insurance contracts and statutory standard fire insurance policies contain exclusions based upon an insured’s material misrepresentation, fraud or concealment concerning the insurance policy.

23. 423 N.W.2d at 713.
to receive benefits to which the insured was not entitled.\textsuperscript{24} After a fire destroyed the trailer and its contents, the insured submitted a claim to the insurer and filed a subsequent action seeking to recover $16,000 for the loss of his trailer and over $14,000 for the loss of personal contents within the trailer.\textsuperscript{25} Although the insurer acknowledged the insured was entitled to compensation for the fire damage loss to his trailer, the insurer contended it had no obligation to pay the insured on the contents claim because the insured had made fraudulent representations as to his personal property lost in the fire.\textsuperscript{26} The insurer counterclaimed against the insured for its attorney's fees pursuant to a state statute which allowed recovery for attorney's fees when a party has:

\ldots acted in bad faith; asserted a claim or defense that is frivolous and that is costly to the other party; asserted an unfounded position solely to delay the ordinary course of the proceedings or to harass; or committed a fraud upon the court.\textsuperscript{27}

The jury in \textit{Gendreau} found that the insured had suffered a personal property loss in the amount of $4,000, rather than $14,000, and that the insured had misrepresented facts with an intent to defraud the insurer as to the nature and extent of his loss.\textsuperscript{28} The trial court denied the insured any recovery, after applying the insurance contract's exclusion of coverage based upon false information provided to the insurer by the insured with the intent to receive benefits to which the insured was not entitled.\textsuperscript{29} The trial court found the insured knew the claim was false when he made it, as substantiated by the jury verdict.\textsuperscript{30} After determining that the insured's filing of an action based upon his false claim was in bad faith and a waste of valuable court resources, the court ordered the insured to pay attorney's fees to the insurer.\textsuperscript{31} On appeal, the Court of Appeals of Minnesota affirmed the trial court's decision to award attorney's fees, noting that the jury had found that the insured misrepresented facts with an intent to defraud the insurer.\textsuperscript{32} The appellate court

\begin{itemize}
\item \textsuperscript{24} \textit{Id.}
\item \textsuperscript{25} \textit{Id.}
\item \textsuperscript{26} \textit{Id.}
\item \textsuperscript{27} \textit{Id.} at 714.
\item \textsuperscript{28} \textit{Id.} at 713-14.
\item \textsuperscript{29} \textit{Id.}
\item \textsuperscript{30} \textit{Id.}
\item \textsuperscript{31} \textit{Id.}
\item \textsuperscript{32} \textit{Id.} at 714.
\end{itemize}
agreed the fees were properly awarded because the insured had brought a frivolous claim to court, not because he had previously made a fraudulent claim to the insurer. Recognizing that the existence of bad faith is a question of fact best left to the sound discretion of the court, the appellate court affirmed, finding that the trial court did not abuse its discretion in awarding attorney's fees to the insurer.

B. Discussion of Recent Unpublished Decisions from Other Jurisdictions Which Provide Convincing Reasons Why Courts Should Recognize a Cause of Action for Reverse Bad Faith

Recent unpublished decisions from other jurisdictions provide further persuasive reasons why courts should allow insurers to assert a counterclaim for reverse bad faith against an insured who brings a frivolous bad faith claim. One decision which provides a discussion of the propriety of allowing an insurer recovery on a counterclaim for bad faith against an arsonist insured is Bernier v. Allstate Insurance Co. In Bernier, the State of Connecticut Superior Court for the Judicial District of Litchfield addressed an

33. Id. The appellate court also rejected the insured's argument that he was the "prevailing" party on the theory that the jury had awarded him damages of $4,000. Id. Instead, the court deemed it necessary for the jury to assess the magnitude of the insured's loss before it could decide whether the claim was fraudulent. The court found that the jury's conclusion that the insured suffered a loss of only $4,000 actually supported the insurer's argument that the claim was fraudulent and therefore the insured was not the "prevailing" party. Id.

34. Id. at 714.


insurer's counterclaim in the context of a bad faith action brought by two insureds, a grandson and his grandmother, who were co-owners of a waterfront residence. The action, which initially also named the insureds' credit union, was brought against the insurer to recover damages under a fire insurance policy. Although the insurer denied the grandson's claim and defended against the action on the grounds that he intentionally set the fire, the insurer paid the grandmother's claims for separate personal property and damage to the dwelling. The only remaining claim was for damage to the grandson's personal property.

In Bernier, the insurer filed a counterclaim against the grandson to recover money it paid as result of the fire loss, including $3,000 for advance living expense paid to the grandson on the day of the fire, over $85,000 paid to the grandmother (and her attorney and mortgagees) in settlement of her dwelling and personal property claims, and $7,500 for demolition, and for the insurer's costs and attorneys fees incurred in investigating and adjusting the claim and defending against the action. After the conclusion of the grandson's evidence at trial, the court dismissed his claim for failure to establish a prima facie case, leaving only the insurer's counterclaim before the court.

The decision in Bernier provides a thorough recitation of the evidence supporting the insurer's denial of the grandson's claim and the defense of the ensuing action on the basis of intentional burning. The trial court found that the insurer had clearly met

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37. Id.
38. Id.
39. Id.
40. Id.
41. Under the law of North Carolina and many other states, when a fire insurance policy issued to a mortgagor contains a standard loss-payable clause, it operates as a separate and independent contract insuring the mortgage interest as between the insurance company and the mortgagee, notwithstanding any allegations of arson or fraud committed by an insured, and any loss paid by the insurer must first be applied to the reduction of the mortgage debt. See, e.g., Employer's Fire Ins. Co. v. British Am. Assurance Co., 259 N.C. 485, 131 S.E.2d 36 (1963); Shores v. Rabon, 251 N.C. 790, 112 S.E.2d 556 (1960).
43. Id. Evidence presented by the insurer at trial included, but was not limited to, expert testimony regarding low burn patterns and multiple points of origin, expert opinion testimony that the fire was of human design and was set, fire debris samples which tested positive for an identifiable accelerant, testimony that the grandson was the last person at the dwelling and had locked the door when he left and firefighters had to force entry, inconsistent statements and an
its burden of establishing, by a preponderance of the evidence, that the fire was of incendiary origin. The court also found that the evidence showed not only that the grandson had the opportunity to set the fire, but also that it would be virtually impossible for anyone else to have set the fire.

The court determined that pursuant to the subrogation terms of the insurance policy and consistent with general insurance law, the insurer was entitled to recover from the grandson in excess of $88,000 for the amount of the loss which it paid to the grandmother and the mortgagees. The court also found that an implied covenant of good faith applies to a wide variety of contractual relationships, including insurance contracts. The court observed that it is well recognized that the duty of good faith and fair dealing rested as much on the grandson as it did on the insurer, and that the grandson's breach of that duty afforded the insurer a cause of action against him. The court reasoned that in setting fire to the insured premises and in suing the insurer, the grandson breached the duty of good faith and fair dealing which arises out of the insurance policy, and that the grandson's act of arson was an attempt to defraud the insurer. The court further reasoned that in view of the grandson's knowledge that the fire was set, any losses resulting from the fire were excluded from the policy and not recoverable. The grandson violated his duty of good faith and fair dealing by filing suit against the unsupported alibi offered by the grandson, threats made by the grandson in an attempt to silence a witness who lived with him at the dwelling, evidence that the grandson was in dire financial straits at the time of the fire and that the property was encumbered by mortgages totalling approximately $250,000, an admission by the grandson that he had submitted falsely inflated tax returns at his Examination Under Oath during the course of the insurer's investigation, previous comments by the grandson that he could burn the house down if he needed money, and evidence negating the grandson's explanation of possible accidental causes of the fire. Id.

44. Id. at 9.
45. Id. at 10, 12.
46. Id. at 19-20.
47. Id. at 21 (citing pertinent state case law and Restatement (Second) of Contracts, § 205 cmt. a (1979), for the proposition that, "[g]ood faith performance or enforcement of a contract emphasizes faithfulness to an agreed upon common purpose and consistency with the justified expectation of the other party. . .").
49. Id. at 22.
insurer to collect insurance proceeds. The court determined the insurer was entitled to recover the damages proximately caused by the necessity of investigating and defending against the grandson's claim, including its expenses in investigating the underlying claim, and all payments made on the claim. The court awarded the insurer the $3,000 advance payment and payments in excess of $85,000 made on behalf of the grandmother, and damages resulting from the breach of the grandson's duty of good faith and fair dealing by bringing the lawsuit, including attorney's fees and expenses of almost $69,000 incurred by the insurer in continuing to defend the action after the grandmother settled her claim and withdrew from the suit.

II. In What Situations Should the North Carolina Supreme Court Recognize a Cause of Action for Reverse Bad Faith?

In North Carolina, there is currently no published decision which directly addresses the recognition of a cause of action for "reverse bad faith." However, North Carolina law does recognize that a finding of bad faith by an insured is a proper consideration in the denial of coverage under an insurance policy. Bad faith of the insured is to be measured by a subjective standard, based upon actual knowledge and an intentional, i.e. purposeful and knowing, failure by the insured to notify the insurer of the loss; bad faith is not to be measured by an objective standard based upon the conduct of a reasonable person. In Tate, the North Caro-

50. Id. at 22.
51. Id.
52. Id. at 22. The court in Bernier also held that in committing his tortious acts, the grandson committed a separate tort of intentional interference with the established contractual relationship between the insurer and the grandmother. Id. at 23. The court reasoned that since the insurance contract relationship between the insurer and the grandmother was not destroyed by the grandson's wrongdoings, a contractual relationship still existed and the grandson intentionally sought to interfere with it by improper or tortious means. Id. Because the insurer's expenses of performing its obligations under the contract were greatly increased by the grandson's conduct in setting fire to the property, the court found the grandson interfered with the contract sufficiently to sustain a cause of action for interference with the contractual relationship, proximately causing the insurer to suffer damages, and entitling the insurer to an award of compensatory damages for the amounts paid on the claim and punitive damages for its attorneys' fees and costs, plus statutory interest. Id. at 24-25.
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lina Supreme Court determined, "[w]here a lack of good faith [by the insured] is found, it is not necessary to determine the issue of prejudice to the insurer." After successive appeals on various issues, the North Carolina Supreme Court held that the trial court's findings were sufficient to support its conclusion that the insured's failure to timely notify its insurer of an accident "lacked good faith," and therefore the insurer was relieved of its obligations under the insurance policy.

One of the most important points established in Tate is that coverage may be denied where an insured acts in bad faith, as judged by a subjective standard, which does not require that the insured possess a bad motive or a specific ill intent, only that the insured must have acted, or failed to act, purposefully and knowingly. In light of the "bad faith of the insured" language in Tate, and the fact that no published North Carolina decision has yet addressed whether North Carolina should recognize a cause of action for reverse bad faith, the issue can and should be brought to the attention of the court in an appropriate bad faith action.

54. Tate, 315 N.C. at 718-19, 340 S.E.2d at 746.
55. Id.
56. Id. Under North Carolina law, the general rule that an insured is not responsible for false answers in his insurance application where they have been inserted by his agent through mistake, negligence, or fraud is not absolute, and applies only if the insured is justifiably ignorant of the untrue answers, has no actual or implied knowledge thereof, and has been guilty of no bad faith or fraud. Goodwin v. Investors Life Ins. Co., 332 N.C. 326, 330, 419 S.E.2d 766 (1992). The issue whether the insured has willfully misrepresented a material fact is generally for the jury, and mere overvaluation of an insured's claim of loss, absent a showing of bad faith, does not by itself constitute willful misrepresentation. Shields v. Nationwide Mut. Fire Ins. Co., 61 N.C. App. 365, 370, 301 S.E.2d 439, 442-43, cert. denied, 308 N.C. 678, 304 S.E.2d 759 (1983) (addressing in part the issue whether the insured's willfulness and bad faith was conclusively established by his pattern of conduct in exaggerating the value of the insured building, and citing Lykos v. American Home Ins. Co., 609 F.2d 314 (7th Cir. 1979) (per curiam), cert. denied, 444 U.S. 1079 (1980) (holding that the evidence established the insured's fraud and false swearing as a matter of law)).
57. This is particularly true because North Carolina is unlike other jurisdictions which do not expressly recognize a duty of the part of an insured to act in good faith. See Tokles, 605 N.E.2d at 945 ("Ohio law does not impose upon an insured a duty to act in good faith in filing, processing or litigating a claim for insurance, the breach of which will give rise to a cause of action in tort by the insurer against the insured."). Since North Carolina does impose a duty of good faith upon an insured, Tate, 74 N.C. App. at 424, 328 S.E.2d at 891, the remedy for an insured's breach of good faith should be to allow a cause of action in favor of the insurer for reverse bad faith.
Although it would not be appropriate in many cases, the recognition of a cause of action for reverse bad faith would be particularly justified in cases involving first-party bad faith litigation involving an intentional burning or material misrepresentation by an insured.58

III. WHAT POLICY ARGUMENTS PROVIDE COMPELLING REASONS WHY THE NORTH CAROLINA SUPREME COURT SHOULD RECOGNIZE A CAUSE OF ACTION FOR REVERSE BAD FAITH?

One of the most compelling reasons favoring the recognition of a cause of action for reverse bad faith is the strong public policy argument against allowing insureds to profit from their own wrongdoing while simultaneously subjecting insurers to inordinate increased costs of investigation, defense and litigation.59 Once an insurer is presented with a fraudulent claim or intentional loss, it must devote an inordinate amount of time, money and resources to investigating and adjusting the claim, resulting in escalating insurance costs, all of which unnecessarily increase the nature and extent of the risk otherwise contemplated under the policy.60 If the insured further compounds the problem by filing frivolous bad faith litigation following the denial of his claim, he further subjects his insurer to unjustified additional expenses for litigation defense and discovery, causing insurance costs to skyrocket. Society as a whole would derive financial benefit from curtailing bad faith claims and frivolous litigation, through

58. It has also been suggested that reverse bad faith should be recognized as an independent tort where an insured is a sophisticated commercial entity which enjoys significant bargaining power. See Anderson, supra note 4, at 532 (citing R. Kent Livesay, Levelling the Playing Field of Insurance Agreements in Texas: Adopting Comparative Bad Faith as an Affirmative Defense Based on the Insured's Misconduct, 24 Tex. Tech. L. Rev. 1201, 1215 (1993)).

59. For further discussion, see, e.g., Richmond, supra note 5, 25 Seton Hall L. Rev. at 139-40.

60. For additional discussion regarding the increased costs to insurers caused by bad faith claims and litigation, see Patrick E. Shipstead & Scott S. Thomas, Comparative and Reverse Bad Faith: Insured's Breach of Implied Covenant of Good Faith and Fair Dealing as Affirmative Defense or Counterclaim, 23 Tort & Ins. L.J. 215, 225-26 (1987). For additional information regarding the dramatic increase in bad faith litigation, particularly concerning financial institution bonds, see Peter C. Haley and Brandt L. Wolkin, Bad Faith and the Financial Institution Bond, 25 Tort & Ins. L.J. 715 (1990).
decreased costs to the insurance industry and resulting lower insurance premiums.

Although North Carolina has noted certain policy reasons for allowing adverse consequences against an insurer for its unjustified and bad faith conduct,\(^6^1\) it is also in the public interest to deter attempts at wrongful financial gain by insureds who have committed tortious acts in the destruction of insured property or the presentation of a false or frivolous claim. It has long been recognized that an insurance company is expected to deal fairly and in good faith with its policyholders.\(^6^2\) However, the duty of good faith is a two-way street, which imposes a duty not only on the insurer, but on the insured as well.\(^6^3\) Since the duty of good faith and fair dealing is a two-way street, imposing the duty not only on the insurer but also on the insured, the rules of the road should be equally enforceable against each traveler on that street. The duty should not be enforced only against the insurer simply because it is perceived as driving a more powerful vehicle. This is in accord with the common law principle that implicit in every contract is the obligation of each party to act in good faith.\(^6^4\) Public policy concerns dictate against encouraging attempts by insureds to

\(^6^1\) \textit{See}, e.g., \textit{Shields v. Nationwide Mut. Fire Ins. Co.}, 50 N.C. App. 355, 359, 273 S.E.2d 756, \textit{cert. denied}, 303 N.C. 182, 280 S.E.2d 454 (1981) ("because of the great disparity of financial resources which generally exists between insurer and insured and the fact that insurance companies, like common carriers and utilities, are regulated and clearly affected with a public interest, we recognize the wisdom of a rule which would deter refusals on the part of insurers to pay valid claims when the refusals are both unjustified and in bad faith"); \textit{Newton v. Standard Fire Ins. Co.}, 291 N.C. 105, 116, 229 S.E.2d 297, 303 (1976) (stating the rule). For further discussion of policy reasons supporting first-party bad faith claims against insurers, see, e.g., \textit{Kallianos, supra} note 1.


\(^6^3\) \textit{See}, e.g., \textit{Tate}, 315 N.C. at 714, 340 S.E.2d at 243 (recognizing an insured's duty to act in good faith); \textit{Handal}, 192 Cal. App. 3d at 696-97 (recognizing that the "duty of good faith and fair dealing in an insurance policy is a two-way street, running from the insured to his insurer as well as vice versa"). \textit{See also} \textit{Anderson, supra} note 4, at 486 (noting that in recent years several courts have held that the duty of good faith and fair dealing is a "two-way street," and citing \textit{Commercial Union Assurance Cos. v. Safeway Stores, Inc.}, 610 P.2d 1038, 1041 (Cal. 1980)); \textit{Richmond, supra} note 5, at 134 (arguing that if the duty of good faith and fair dealing is truly a "two way street," then, "[w]ith mutual duties should come mutual remedies").

\(^6^4\) \textit{Great Am. Ins. Co.}, 303 N.C. at 399 (citing 17 Am. Jur. 2d, Contracts, §256 (1964)).
profit from their wrongdoing, and fully justify allowing insurers to apply the concept of reverse bad faith in first-party actions to "turn the shield into a sword\textsuperscript{65}\textsuperscript{66} by seeking affirmative relief against their insureds.

IV. Until the North Carolina Supreme Court Recognizes a Cause of Action for Reverse Bad Faith, What Remedies Are Available to Fight Against a Fraudulent First-Party Claim or Bad Faith Claim Presented by an Insured?

A. Key Policy Exclusions and Conditions

In the context of insurance coverage determinations, various policy conditions and exclusions are available to an insurer to evaluate coverage in a claim involving intentional burning, fraud or material misrepresentation. Most policies contain certain stated Exclusions and Conditions which provide contractual grounds for an insurer to fight against an intentional loss or fraudulent insurance claim, with language similar to the following:

\begin{quote}
\textbf{Concealment or Fraud}

The entire policy will be void if, whether before or after a loss, an insured has:
\begin{itemize}
  \item [a)] intentionally concealed or misrepresented any material fact or circumstance;\textsuperscript{66}
  \item [b)] engaged in fraudulent conduct; or
  \item [c)] made false statements; relating to this insurance.
\end{itemize}
\end{quote}

Some standard form policy terms exclude coverage for the following:

\textsuperscript{65} See Richmond, \textit{supra} note 4, at 61-70; Anderson, \textit{supra} note 4, at 528-33. See also Shipstead & Thomas, \textit{supra} note 5; Dobbyn, \textit{supra} note 5.

\textsuperscript{66} It has been held that to prevail on an affirmative defense of misrepresentation and void a fire insurance policy, an insurer must prove that the insured knowingly and willfully made statements that were false and material. Harris v. North Carolina Farm Bureau Mut. Ins. Co., 91 N.C. App. 147, 370 S.E.2d 700 (1988); Bryant v. Nationwide Mut. Fire Ins. Co., 313 N.C. 362, 329 S.E.2d 333 (1985). However, it has also been held that an insured who signs an application for insurance adopts it as his statement, and the fact that he may have made a misrepresentation unknowingly does not, in the absence of bad faith on the part of the insurer or its agent, alter the effect of the misrepresentation. Pittman v. First Protection Life Ins. Co., 72 N.C. App. 428, 325 S.E.2d 287, \textit{cert. denied}, 313 N.C. 509, 329 S.E.2d 393 (1985), \textit{aff'd}, 79 N.C. App. 431, 339 S.E.2d 441, \textit{cert. denied}, 316 N.C. 733, 345 S.E.2d 391 (1986).
(1) **INTENTIONAL LOSS**, meaning any loss arising out of any act committed:
   a) by or at the direction of the insured; and
   b) with the intent to cause a loss;

(2) **NEGLECT**, meaning neglect of the insured to use all reasonable means to save and preserve property at and after the time of the loss; and

(3) **INCREASING THE HAZARD**, which excludes coverage for any acts by the insured which increase the hazard or risk to the insured property.

Of additional importance are certain stated policy Conditions which specify the insured's Duties After Loss. The Duties After Loss require a level of cooperation by the insured which is concomitant with the insurer's contractual and statutory obligations to conduct a prompt and reasonable investigation, evaluation and adjustment of the insured's claim. The Duties After Loss include the submission of the Proof of Loss form and supporting Contents Inventory. The Duties After Loss also require the insured to cooperate in the investigation and handling of the loss, usually by requiring that as often as the insurance company may reasonably require an insured must:

1. show the damaged property;
2. provide the insurance company with requested records and documents and permit them to make copies.

67. For a discussion of the significance of the insured's duty to cooperate in his Duties After Loss, see Shipstead & Thomas, supra note 60, at 227-28.

68. See also lines 113 through 116 of the “Standard 165 Lines” discussed supra in text pp. 28-30 and incorporated into N.C. GEN. STAT. § 58-44-15 (1994), which provides in part:

   ... The insured, as often as may be reasonably required, shall exhibit to any person designated by this Company all that remains of any property herein described, and submit to examinations under oath by any person named by this Company, and subscribe the same; and, as often as may be reasonably required, shall produce for examination all books of account, bills, invoices and other vouchers, or certified copies thereof if originals be lost, at such reasonable time and place as may be designated by this Company or its representatives, and shall permit extracts and copies thereof to be made.


69. Although the financial condition of the insured is relevant to an arson defense, the statutory “production of documents” clause in the standard fire insurance policy does not expressly authorize an insurer's unlimited access to any and all of an insured's business and financial records. Chavis v. State Farm
submit to an Examination Under Oath, while not in the presence of any other insured and sign the same.\textsuperscript{70}

B. "Standard 165 Lines" of the Standard Fire Insurance Policy

In North Carolina, and most other states, in addition to the language set forth in the insurance contract, there is a form statute setting forth the "Standard 165 Lines" of the Standard Fire Insurance Policy, which by statute is automatically written into every fire insurance policy issued in North Carolina for property in this state.\textsuperscript{71} The language of the "Standard 165 lines" incorporated into §58-44-15 of the North Carolina General Statutes, is broad enough not only to deny an insurance claim where the insured participated directly or indirectly in the intentional burn-

\textsuperscript{70} An insured can be barred from recovery under an insurance policy for failing to submit to an Examination Under Oath. Fineberg v. State Farm, 317 N.C. 683, 687, 346 S.E.2d 496, 498 (1986). Where an insured was reasonably requested by an insurer to submit to an Examination Under Oath before suit was filed, but she refused to do so, her later willingness to be examined after she filed suit did not satisfy her duty under the policy and her suit was properly dismissed. Baker v. Independent Fire Ins. Co., 103 N.C. App. 521, 522, 405 S.E.2d 778, 779 (1991).

ing, but also where the insured is involved in other types of willful concealment, misrepresentation, fraud or false swearing.\footnote{72}

The language of the "Standard 165 Lines" also expressly provides an insurer with a right of subrogation against a tortfeasor to the extent of payment on a loss through the following provisions:

Lines 162 through 165:

**Subrogation.** This company may require from the insured an assignment of all right of recovery against any party for loss to the extent that payment therefor is made by this company.

Lines 78 through 83:

If this Company shall claim that no liability existed as to the mortgagor or owner, it shall, to the extent of payment of loss to the [designated] mortgagee, be subrogated to all the mortgagee's rights of recovery, but without impairing mortgagee's right to sue, or it may pay off the mortgage debt and require an assignment thereof and of the mortgage.\footnote{73}

In addition to the terms automatically incorporated into each policy under § 58-44-15, almost all fire insurance contracts contain policy language similar to the subrogation provisions set forth above. The clause in the standard fire insurance policy which provides that the insured shall not collect "in any event for more than the interest of the insured" limits a mortgagee's interest to the amount of the mortgage debt outstanding at the time of the fire.\footnote{74}

\footnote{72. Some of the most pertinent provisions of the "Standard 165 Lines" incorporated within N.C. Gen. Stat. § 58-44-15 (1994), include the following:}

Lines 1 through 6:

**Concealment, Fraud.** This entire policy shall be void if, whether before or after a loss, the insured has wilfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

Lines 11 through 13, and 21 through 24:

**Perils Not Included.** This Company shall not be liable for loss by fire or other perils insured against in this policy caused, directly or indirectly, by: . . . (i) neglect of the insured to use all reasonable means to save and preserve the property at and after a loss, or when the property is endangered by fire in neighboring premises. . .

Lines 28 through 32:

**Conditions Suspending or Restricting Insurance.** Unless otherwise provided in writing added hereto this Company shall not be liable for loss occurring: (a) while the hazard in increased by any means within the control or knowledge of the insured; . . .


\footnote{74. Employers' Fire, 259 N.C. 485, 131 S.E.2d 36.}
C. Declaration of the Rights and Obligations of Parties to the Insurance Contract

Under Rule 57, North Carolina Rules of Civil Procedure, an insurance company may bring a declaratory judgment action, by filing a lawsuit naming the insured, to define the rights and duties of the parties under an insurance policy. Under Federal law, the procedure for obtaining a declaratory judgment pursuant to 28 U.S.C. §2201, shall be in accordance with Rule 57 of the Federal Rules of Civil Procedure. A declaratory judgment action enables an insurance company to take the first affirmative step to show its good faith in requesting the court to declare the rights of the parties concerning coverage issues, rather than having to wait to be sued for any alleged breach of contract or bad faith claims which may arise from the insurer’s denial of coverage. Under Rules 38 and 39 of the Federal and North Carolina Rules of Civil Procedure, an insurance company may demand a trial by jury.

D. Statutory Provisions Allowing Recovery of Attorneys Fees

Section 1D-45, North Carolina General Statutes, allows for an award of attorney’s fees as follows:

FRIVOLOUS OR MALICIOUS ACTIONS; ATTORNEYS' FEES
The court shall award reasonable attorneys’ fees, resulting from the defense against the punitive damages claim, against a claimant who files a claim for punitive damages that the claimant knows or should have known to be frivolous or malicious. The court shall award reasonable attorney fees against a defendant who asserts a defense in a punitive damages claim that the defendant knows or should have known to be frivolous or malicious.

Nothing in § 1D-45 indicates it would be unavailable to support an award of attorney's fees in favor of an insurer in the defense of a frivolous bad faith action.

E. Rules of Civil Procedure Allowing Sanctions

Under Rule 11, North Carolina Rules of Civil Procedure, a court may award sanctions against an attorney or party who signs any pleading, motion or other paper in violation of the rule, which requires that such documents be well grounded in fact and sub-
mitted in good faith.\textsuperscript{78} Other jurisdictions have suggested that sanctions under such a rule be awarded when an insured brings a frivolous action or bad faith claim.\textsuperscript{79} However, as previously noted, since courts do not customarily award sanctions for the full amount of a party's damages, costs and expenses, including attorney's fees, it is doubtful that an insurer facing a frivolous bad faith claim could be made whole with an award of sanctions, without allowing it to pursue full recovery of its damages through an affirmative counterclaim for reverse bad faith.

\textbf{F. Statute Allowing Post-Conviction Recovery for Insurance Fraud}

Beginning October 1, 1995, under § 58-2-161 of the North Carolina General Statutes, once there has been a criminal conviction of the insured, for violations occurring on or after that date, an insurer may bring a civil action to recover compensatory damages, attorneys' fees, costs, reasonable investigative costs and, where appropriate, treble damages, based upon an insured's false statement to procure benefits under an insurance policy.\textsuperscript{80} How-

\textsuperscript{78} Rule 11 states in relevant part:

\ldots The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion or other paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. \ldots If a pleading, motion or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

\textsuperscript{79} See, e.g., \textit{Johnson}, 533 N.W.2d at 208 (addressing Iowa's Rule 80(a) allowing attorney's fees as sanctions).

\textsuperscript{80} That section provides in part:

\textsection{58-2-161. False statement to procure or deny benefit of insurance policy or certificate.} 
(b) Any person who, with the intent to injure, defraud, or deceive an insurer or insurance claimant:

(1) Presents or causes to be presented a written or oral statement, including computer-generated documents as part of, in support of, or in opposition to, a claim for payment or other benefit pursuant to an
ever, because §58-2-161 only provides relief to an insurer after there has already been a criminal conviction in a separate proceeding, the need for relief in the nature of a counterclaim for reverse bad faith still remains.

V. Caveat: In cases involving the innocent spouse doctrine, any reverse bad faith claim must be directed only against the wrongdoer spouse.

Many jurisdictions, including North Carolina, currently recognize the "innocent spouse" doctrine, which allows recovery of a share of insurance proceeds by an insured spouse who did not participate directly or indirectly in the intentional burning, even though the fire loss resulted from an intentional burning by the guilty spouse.81 Despite any limitations presented by an innocent spouse situation, an insurer should still be entitled to assert a

insurance policy, knowing that the statement contains false or misleading information concerning any fact or matter material to the claim, or

(2) Assists, abets, solicits, or conspires with another person to prepare or make any written or oral statement that is intended to be presented to an insurer or insurance claimant in connection with, in support of, or in opposition to, a claim for payment or other benefit pursuant to an insurance policy, knowing that the statement contains false or misleading information concerning a fact or matter material to the claim is guilty of a Class H felony. Each claim shall be considered a separate count. Upon conviction, if the court imposes probation, the court may order the defendant to pay restitution as a condition of probation. In determination of the amount of restitution pursuant to G.S. 15A-1343(d), the reasonable costs and attorneys' fees incurred by the victim in the investigation of, and efforts to recover damages arising from, the claim, may be considered part of the damage caused by the defendant arising out of the offense.

In a civil cause of action for recovery based upon a claim for which a defendant has been convicted under this section, the conviction may be entered into evidence against the defendant. The court may award the prevailing party compensatory damages, attorneys' fees, costs, and reasonable investigative costs. If the prevailing party can demonstrate that the defendant has engaged in a pattern of violations of this section, the court may award treble damages.


claim for reverse bad faith against a guilty spouse for recovery of amounts paid by the insurer to any innocent co-insureds, mortgagees or lienholders for damages to real or personal property, for recovery of the insurer's expenses incurred in the investigation of the underlying claim, for advance payments and additional living expenses, for costs of clean up, repair, demolition, and debris removal, and for attorney's fees and costs incurred in defending against any litigation arising from the insured's claim. 82

VI. CONCLUSION

Under the law of North Carolina and most other states, there is currently no recognized cause of action for reverse bad faith to protect insurers against insureds' tortious acts, fraudulent claims and frivolous bad faith litigation. Unless and until courts adopt the tort of reverse bad faith, there will be little disincentive for an insured to file a fraudulent claim for frivolous bad faith litigation. With the recent proliferation of bad faith lawsuits, there is an increasing need for courts to "even up the scales" so that in appropriate circumstances an insurer may respond to unjustified bad faith allegations with a bad faith counterclaim against the insured. The arguments in favor of recognizing a claim for reverse bad faith are particularly compelling in the areas of arson and insurance fraud, where public policy considerations dictate against allowing an insured to profit from his own wrongdoing. The time has come to recognize a cause of action for reverse bad faith and allow insurers to fight fire with fire.