BREAKING BAD FAITH

DOES LEGISLATING PRIVATE CAUSES OF ACTION AGAINST INSURERS DO MORE HARM OR GOOD?

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For state lawmakers, proposed bills designed to protect policyholders from bad faith insurance practices can often appear popular and sensible on paper. In practice, however, so-called bad faith bills are often drafted without a firm appreciation of the robust common law protections against improper insurance claim handling conduct that already exist in most U.S. jurisdictions. Thus, like the character arc explored in the critically acclaimed television series Breaking Bad, even well-intentioned efforts to legislate insurance claim practices can lead to unintended negative consequences.

Anyone generally familiar with AMC's Breaking Bad series will recall that its protagonist, Walter White, took desperate measures to protect his family after learning he was terminally ill – yet those well-intentioned measures wound up jeopardizing the very family he vowed to protect.Analogously, bills aimed at stopping insurers from engaging in bad faith claim practices do not always benefit consumers or improve claim handling. In many instances, bad faith bills can conflict with existing state common laws or render them unclear, while undermining the authority of state insurance regulators, resulting in more confusion and litigation. Additionally, bad faith legislation can be wielded by trial lawyers as a cudgel to force insurers to pay claims or settle lawsuits that are defensible, ultimately hurting insureds through increased costs and premiums.

In fact, many of these bad faith laws have been used by policyholder attorneys as tools to threaten jackpot verdicts through treble damages and fee-shifting. Additionally, the bills exacerbate coverage litigation, clogging courts and keeping meritorious suits from being decided. Thus, bad faith laws, while ostensibly designed to protect insureds, can often lead to confusion in existing bad faith jurisprudence.

For example, in 2007, the Washington State legislature enacted the Insurance Fair Conduct Act to provide insureds with a private bad faith cause of action against insurers who unreasonably deny coverage. On its face, the act broadly addressed unfair insurer practices, but Washington courts have been split on its scope since enactment. In particular, in 2017 the Washington Supreme Court finally ruled, after a decade of hotly debated litigation, that the act creates a private cause of action only where an unreasonable denial of coverage has taken place, but not for alleged unfair claim handling practices and regulatory violations. Even after this ruling, however, Washingtonians continue to debate what constitutes an "unreasonable denial" as the term is undefined in the act. Accordingly, this act purportedly designed to clarify insurer good faith obligations and reduce insurance litigation has in many respects achieved the opposite result.

In 2022, New Jersey became the most recent state to codify private causes of action for so-called bad faith with the enactment of the New Jersey Insurance Fair Conduct Act ("NJIFCA"). Originally conceived to apply broadly to multiple lines of insurance, the final version of NJIFCA passed into law is applicable only to uninsured and underinsured motorist claims.

The NJIFCA is illustrative of how these private causes of action can result in confusion. It creates a private cause of action for claimants who have suffered "an unreasonable delay or unreasonable denial" of a claim for payment of benefits under an insurance policy in connection with uninsured and underinsured motorist claims. Successful claimants under the NJIFCA can claim up to three times the coverage amount, plus interest, costs and attorneys' fees as damages. However, the NJIFCA fails to define what constitutes an "unreasonable" denial or delay, nor does it specify what conduct will satisfy this standard, what statute of limitation applies, and whether it applies to claims made prior to its effective date. With arguments emerging on all sides of these issues, it will be left to the already over-burdened judiciary to fill these gaps in the statutory language.

In Massachusetts, insureds can bring a private cause of action against an insurer if it fails to promptly settle a claim within a statutory 30-day window or as soon thereafter as "liability has become reasonably clear," but the operative statute provides little guidance as to what factors make liability "reasonably clear" to an insurer. Accordingly, the Massachusetts law has resulted in litigation over this undefined term and other provisions, including fee shifting and awarding of multiple damages. Here again, a bill purportedly designed to clarify insurers' obligations and avoid litigation can result in more confusion and litigation than before its enactment.

Similarly, Montana residents can bring private causes of action against insurers for which an insurance company can be found liable to its insured and/or an injured third party for various types of alleged conduct, ranging from claims the insurer misrepresented insurance terms to the alleged failure to promptly settle claims. Claims can be made by the insured within two years of the alleged violation or by third-party claimants within one year from the date of the settlement of or entry of judgment on the underlying claim. Montana's Unfair Trade Practices Act lists a number of potential violations but fails to define key terms.

California has a comprehensive bad faith statutory scheme that forbids, among other things, denying a claim without a "reasonable" cause, failing to establish "reasonable standards" for claim handling, and failing to respond to a claim "promptly." Recoverable damages for such claims include attorneys' fees and costs of suit, emotional distress and punitive damages – in addition to payment of the claim itself.

Florida's bad faith statute was amended in 2019 to specifically include a provision requiring policyholders to file a Civil Remedy Notice as a prerequisite before commencing bad faith litigation against an insurer for certain types of claims. The impetus for including this requirement was to avoid unnecessary bad faith litigation, and commensurately, reduce costs. States whose bad faith statutes do not include a similar notice provision, or other conditions precedent to filing bad faith lawsuits, should not be surprised when the proverbial floodgates of litigation open.

In New York, the state legislature has been examining Bills 7285 and 5623 or variations thereof for nearly 10 years. These proposed bad faith bills would, respectively, create private causes of action against insurers who refuse or delay payment of claims and allow policyholders to recover consequential damages, attorneys' fees and interest if successful against insurers. If enacted, the legislation would immediately put insurers on the defensive by imposing arbitrary claim response times and expose insurers to multiplied damages for technical violations.

Similarly, state legislators in Oregon and other U.S. jurisdictions are considering bad faith bills. Over the past several years, various Oregon house and senate bills have been drafted to codify insurance bad faith standards, yet suffered many defects, including undefined terms. In 2019, the Virginia legislature considered a bad faith bill that would have allowed suits against insurers for refusing a "reasonable" settlement demand, but that bill died in committee. These types of bad faith bills, if enacted, can lead to inflated settlement demands, encourage more lawsuits, create incentives for insurance fraud, and clog judicial systems. Additionally, statutory bad faith laws can effectively redefine contractual relationships between insurers and their insureds to the detriment of insureds through increased insurance costs and premiums.

Like Walter White's initial stated goal to support his family, bad faith laws can be well-intentioned and marketed as protective of consumers. In reality, however, these private causes of action can do more harm than good. Statutory bad faith schemes can incentivize unscrupulous policyholder attorneys to commence bad faith litigation anytime they are displeased with an insurer's coverage determination and use the threat of treble damages and fee-shifting to justify outrageous demands, all of which can increase the number of litigated disputes and drive up insurance costs. Additionally, statutory bad faith schemes often fail to account for existing common law standards and insurance regulations, resulting in inconsistencies and confusion. Any legislation aimed at curbing bad faith claim practices should give due consideration to existing common law and clearly define key terms.

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