Bad faith legislation: Good for insurance policyholders?

WHEN AN INSURANCE COMPANY VIOLATES ITS DUTY OF GOOD FAITH AND FAIR DEALING, A POLICYHOLDER SHOULD HAVE A REMEDY FOR THE INSURANCE COMPANY'S BREACH OF DUTY.

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IN ORDER for insurance purchasers to receive the benefit of their insurance policies, bad faith behavior by insurance companies requires that a remedy be available. A July 2019 NU PropertyCasualty360 column by a lobbyist for the insurance industry articulated an insurance industry creed: "Plainly and simply, bad faith legislation is solely for the benefit of the plaintiffs' attorneys."

Is that somewhat alarmist declaration really so?

SKEWED INCENTIVES REQUIRE BAD FAITH BALANCING

When an insurance company violates its duty of good faith and fair dealing, should a policyholder have a remedy for the insurance company's breach of duty? The answer must be "Yes." Bad faith legislation, like common law duties, helps policyholders obtain the benefit of the policies they buy. In the absence of such a remedy, insurance companies will breach their obligations with virtual impunity, because breaching their duties will be almost without cost.

Commentators addressing the damages available for breaches of contracts have been noting the need for a remedy for over half a century. When a contracting party willfully breaks its promise to perform because performance, as promised, would cost more than the damages recoverable in an action for breach of contract, courts have shown a willingness to take the willfulness of the breach into account in determining the damages awardable against the breaching party.

Because the insurance product is in the nature of an aleatory (that is, uncertain) promise — the insurance policy is sold and paid for long before performance of the insurance company is needed — an incentive is created for an opportunistic breach of that long-term promise to pay. Over the years commentators have observed that this "money for promise" arrangement in insurance provides a powerful strategic tool for insurance companies to use against their customers.

The argument that insurance purchasers should have remedies that balance this distorted strategic advantage has been updated continually, including this year, as noted in the Restatement of the Law of Liability Insurance. Though insurance companies and their lobbyists would prefer that policyholders not have redress for such wrongs, such redress remains available. Even the American Law Reports (ALR), not a policyholder advocate, concedes as much:

[I]t has been held that the intentional, bad-faith refusal of an insurer to make payments due under an insurance policy constitutes a tortious interference with a protected property interest of its insured, for which damages may be recovered to compensate for all detriment proximately resulting therefrom, including economic loss… resulting from the conduct or from the economic losses caused thereby. Further,… it has been held that,… punitive or exemplary damages may be recovered from an insurer guilty of wrongfully delaying or refusing to make payments due under an insurance contract, in addition to the awarding of consequential damages. [What Constitutes Bad Faith on Part of Insurer Rendering It Liable for Statutory Penalty Imposed for Bad Faith in Failure To Pay, or Delay in Paying, Insured's Claim — Particular Conduct of Insurer, 115 A.L.R. 5th 589.]

CONSEQUENTIAL DAMAGES AND ATTORNEYS' FEES

Among others, three types of damages available to policyholders help correct the strategic imbalance between insurance company and policyholder at the time an insurance claim is made:

1. Damages for a failure to settle;
2. Recovery of attorney's fees in the insurance recovery action; and
3. Consequential damages from the breach of the insurance policy.

Even New York, which remains a jurisdiction protective of insurance companies, recognizes claims against insurance companies for bad faith failure to settle. In New York, "a bad faith case is established where the liability is clear and the potential recovery far exceeds the insurance coverage." [DiBlasi v. Aetna Life and Cas. Ins. Co., 147 A.D.2d 93, 98 (App. Div. 2d Dep't 1989).]

[T]he law imposes upon the carrier the obligation of good faith which is basically the duty to fairly consider the insured's interests as well as its own in making the decision as to settlement. In arriving at a workable standard so that the concept could be clear to a juror,… Was it highly probable that the insured would be subjected to personal liability? [DiBlasi, 147 A.D.2d at 99.]

Further, many jurisdictions have awarded attorneys' fees to policyholders forced to litigate with their insurance companies when coverage was clearly indicated. A policyholder "who is 'cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations' and who prevails on the merits, may recover attorneys' fees incurred in defending against the insurer's action." [Mighty Midgets, Inc. v. Centennial Ins. Co., 47 N.Y.2d 12, 21 (1979)]. In fact, as my colleague Vivian Michael and I previously have written, most states provide some form of potential recovery of attorneys' fees when a policyholder is forced to litigate with its insurance companies.

Consequential damages for breach of an insurance policy also are available to policyholders facing wrongful denials. [See Bi-Economy Market, Inc. v. Harleysville Ins. Co., 10 N.Y.3d 187 (2008).] In the Bi-Economy Market case, an insurance company's long delay followed by partial payment of a claim following a fire loss was found to have led to the company's death. The New York Court of Appeals awarded consequential damages.

Most policyholders battle adverse claimants and the plaintiffs' bar. The availability of remedies for insurance company breaches of duty is far from a radical benefit solely for plaintiffs' attorneys. Rather, in the system of risk transfer embodied in the Western insurance and liability markets, the availability of such remedies corrects a strategic imbalance and un-tilts the playing field somewhat, permitting policyholders to obtain the benefits of the insurance product that they paid hard-earned premium dollars to obtain.

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