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NEW JERSEY
ALERT

October 2013

Will New Jersey Policyholders Win Better Bad Faith Laws in the Wake of Superstorm Sandy?

By Robert D. Chesler, Steven J. Pudell and Beth D. Simon

As the anniversary of Superstorm Sandy's October 29, 2012, landfall passes, New Jersey lawmakers are rightly considering whether New Jersey law offers sufficient protection to insurance policyholders subject to undue delay, underpayment or unjustified denial of their insurance claims.

Sandy, the latest in a series of storms on the eastern seaboard that in recent years have resulted in catastrophic loss to property and business owners, was particularly devastating to shoreline communities. In New Jersey, with its long coastlines on the Hudson River and Atlantic Ocean, business losses alone were in the range of $30 billion, according to early estimates. New Jersey businesses made over 36,000 property damage claims, according to the New Jersey Department of Banking and Insurance.

Many property damage claims for businesses and homeowners alike were mishandled, drawing public attention to insurance company practices that result in the wrongful delay of payment or underpayment of claims. In many states such practices, if proven in court, would support a claim of bad faith claims handling. Until now, policyholders in New Jersey have had little recourse against insurance companies that acted in bad faith.

However, both the Legislature and the state Supreme Court now have bad faith matters before them. These matters have the potential to change the bad faith landscape in New Jersey and strengthen the remedies available to policyholders.

Legislative Response

New Jersey Assemblyman Reed Gusciora has just introduced Bill A-4382. This bad faith bill would only be effective during states of emergency declared by either the governor or president. It would basically create a private right of action for unfair claim settling practices — the current statute does not have such a right. Damages would include attorney's fees, prejudgment interest, recovery in excess of policy limits, and punitive damages.

A similar bill is already pending in New Jersey. Following Hurricane Irene, Senator Nicholas Scutari introduced Senate Bill No. 3036, which provides a cause of action for policyholders subject to bad faith claims handling. The bill proposed in the New Jersey Assembly, A-4382, would

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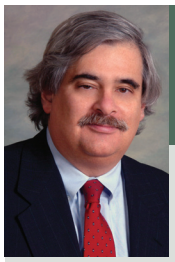

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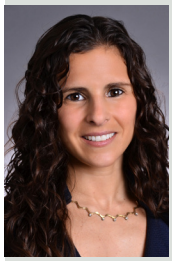

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create a bad faith cause of action for the insurance company's breach of the covenant of good faith and fair dealing, which is read into every contract (including insurance policies) in New Jersey. A breach of this covenant "shall include the insurer's failure to attempt in good faith to effectuate a prompt, fair and equitable settlement of a claim." Under Senate Bill No. 3036, an insurance company is liable for bad faith where a claimant proves that: "the insurer acted unreasonably in the investigation, evaluation, processing, payment or settlement of the claimant's claim for coverage under the policy or without a reasonable basis in denying the coverage." Damages would include recovery in excess of the policy limits, attorney's fees and, in cases of "actual malice or wanton and willful disregard of any person who foreseeably might be harmed by the insurer's acts or omissions," punitive damages. *Id*.

Current Bad Faith Law In NJ

Under current New Jersey law, bad faith claims for property damage are subject to the "fairly debatable" standard established in *Pickett v. Lloyd's*, 131 N.J. 457 (N.J. 1993). Under this test, a policyholder must show that there is no reasonable basis for the insurance company's denial of the benefits of the policy and show the insurance company's knowledge of or reckless disregard for the lack of reasonable basis for denying the claim. *Id*. at 473. As discussed below, this standard can benefit insurance companies who act in bad faith but can find a debatable rationale for their conduct. The *Pickett* standard has proven too high: since the decision was handed down, no insurance company has been found liable for bad faith, much less been sanctioned by extra-contractual damages.

Moreover, where the breach is not accompanied by malice, the court will only award consequential damages, which are difficult for policyholders to document. Even in *Pickett*, the court questioned the plaintiff's claim for consequential damages. As a result, insurance companies are not penalized for delayed payment or underpayment of claims. At most, they just have to pay what they should have paid in the first place.

While punitive damages are also available under *Pickett*, such an award requires further proof that the insurance company's conduct was "wantonly reckless or malicious." Conduct that reaches this standard, the court has said, includes "threats by the insurer's agents to kill the insured and the insured's children." *Id*. at 475. No published decision has ever awarded damages to a policyholder applying this standard.

Badiali v New Jersey Manufacturers Insurance Group

Badiali perfectly captures the tension between bad faith conduct and the Supreme Court's "no reasonable basis" test. The insured unsuccessfully argued to the trial court that the insurance company's position was taken in bad faith. On appeal, the insurance company produced for the first time an unreported 10-year-old case that supported its position. The insurance company did not produce an

affidavit to demonstrate that it had in fact relied on the case. However, the Appellate Division held that since a reasonable basis to deny coverage existed, the insurance company was not in bad faith — even if the insurance company did not rely on that reasonable basis. The court's use of an objective standard ignored whether in fact subjectively the insurer acted in bad faith.

Conclusion

Insurance companies handle most claims professionally. However, the broad norm is little comfort to policyholders whose claims are delayed or ignored. In such situations, few good options exist. Most small businesses and homeowners cannot afford to pay for potentially endless litigation, and the courts do not have the power to award attorney's fees in litigation involving property policies. *See R.* 4:42-9. A policyholder with few means is forced to find a lawyer willing to do the work on a contingent fee basis. Most contingent fee attorneys demand one-third of the recovery as payment. With no access to consequential damages, then, policyholders' best hope is to recover two-thirds of what was originally owed to them, probably after years of delay and uncertainty. If policyholders subject to bad faith claims handling are to be made whole, New Jersey needs better developed bad faith law.