COMMON-SENSE CONSTRUCTION OF UNFAIR CLAIMS SETTLEMENT STATUTES: RESTORING THE GOOD FAITH IN BAD FAITH

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INTRODUCTION

Over the past twenty-five years, the law of "bad faith" has grown from infancy as a compensable action in contract law into a major source of tort litigation.[1] During this relatively short gestation period, at least in comparison to other legal actions, this new body of tort, grounded in an implied contractual or fiduciary duty not to act in

1. *See* Mark J. Browne, Ellen S. Pryor & Bob Puelz, *The Effect of Bad Faith Laws on First-Party Insurance Claims Decisions*, 33 J. LEGAL STUD. 355, 355 (2004) (discussing the emergence of an "extracontractual cause of action against insurers for bad-faith denial of a claim filed by an insured for benefits allegedly due to the insured under the policy"); *see also* Hartford Underwriters Ins. Co. v. Williams, 936 So. 2d 888, 895 (Miss. 2006) ("A bad faith insurance claim represents one of the most familiar types of punitive damages claims known to our case law."); Fight Bad-faith Insurance Companies (FBIC), http://www.badfaithinsurance.org/ (last visited July 27, 2009) (reporting that there are "many hundreds of thousands to a million or more" bad-faith claimants).

bad faith in any dealing, or conversely to act in good faith,[2] has shifted the balance of power in many transactions.[3] As intended, plaintiffs' ability to bring a separate tort action has helped to curb abuse and unfair practices.[4] Unfortunately, as quickly as bad-faith law developed to come to the aid of the disadvantaged party in a contract or fiduciary relationship, it has evolved into a litigation quandary that often misses its basic purpose. With every state adopting statutes to govern certain types of bad-faith actions,[5] litigation of such claims has gone beyond simply righting wrongs to become a big business of its own. In some cases, enterprising plaintiffs' attorneys seek out technical violations to bring a bad-faith action where there is no purposeful or malevolent will, or even a remotely unfair act.[6] In legitimizing such claims, bad-faith law has lost its way. Today the law may actually facilitate bad faith in the very manner in which these laws were meant to combat it.

Principal among laws governing bad faith are those related to insurance practices, which are the subject of this Article. In response to alleged insurer abuses, states have, in some form, attempted to legislate "bad faith" in the handling of insurance claims practices.[7] Yet, in attempting to define the amorphous concepts of bad faith and unfair practices, many states have opened the door to claims that do

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2. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

3. *See* Nichols v. State Farm Mut. Auto. Ins. Co., 306 S.E.2d 616, 619 (S.C. 1983) (arguing that without the availability of such tort claims, insurance companies would be able to arbitrarily deny claims without the threat of regulatory enforcement).

4. *See infra* notes 19–24 and accompanying text (describing potentially harmful practices insurers were able to engage in due to the limited and proscribed remedies available to claimants prior to statutory and judicial reforms).

5. *See, e.g.*, ALA. CODE § 6-5-156.5 (LexisNexis 2005) (bad-faith cause of action for initiating drug-related claim); ALASKA STAT. § 23.20.390 (2008) (bad-faith cause of action relating to workers' compensation claim); MISS. CODE ANN. § 63-17-161 (2004) (bad-faith cause of action against consumers making motor vehicle warranty claims); S.C. CODE ANN. § 63-7-430 (2008) (bad-faith cause of action for misreporting child abuse); TENN. CODE ANN. § 40-33-215 (2006) (bad-faith cause of action for seizing or failing to return property in forfeiture); *see also, e.g.*, statutes cited *infra* note 47.

6. The California Supreme Court, a pioneer in bad-faith jurisprudence, *see infra* Part II.A, was among the first to recognize this growing problem: "It seems . . . that attorneys who handle policy claims against insurance companies are no longer interested in collecting on those claims, but spend their wits and energies trying to maneuver the insurers into committing acts which the insureds can later trot out as evidence of bad faith." White v. W. Title Ins. Co., 710 P.2d 309, 328 n.2 (Cal. 1985) (Kaus, J., concurring and dissenting); *see also* Neil A. Goldberg et al., *Can the Puzzle Be Solved: Are Punitive Damages Awardable in New York for First-Party Bad Faith?*, 44 SYRACUSE L. REV. 723, 723 n.1 (1993) (predicting bad faith insurance law "will significantly impact the insurance industry in the 1990s").

7. *See infra* note 47 and accompanying text (illustrating the widespread adoption of statutes addressing insurers' unfair claims settlement practices).

not appropriately fit in tort law, but rather should be left to traditional contract remedies or state regulatory enforcement. The result is that insurers in some states are at risk of being deprived of their ability to challenge a reasonably disputed insurance claim. Further, they may be unable to make a swift correction of human error without facing the prospect of a tort claim, including punitive or exemplary damages.[8] These damages can toll in the millions of dollars for a single claimant's recovery.[9] Such tort claims are also increasing in frequency and amount at a time when the regulation of insurer practices is at its most comprehensive, leading to an incongruity where instead of heightened penalties and regulations operating to reduce the incidence of bad-faith claims, more claims have been encouraged.[10] Without reasonable boundaries in bad-faith actions, courts may permit claimants to engage in abusive practices against insurers. This establishes an avenue for windfall recoveries for some claimants and offsets the insurance industry's delicate tension between providing recovery and protecting against fraud and overpayment—each a cost which is internalized and ultimately borne by consumers.

This issue takes on added urgency now that many states are again examining the adoption of bad-faith causes of action against insurers. For example, in the past two years, Colorado, Maryland, Minnesota, and Washington have each significantly amended their bad-faith laws.[11] A number of other states have also considered legislatively

8. *See infra* Part II.A.4 (recommending that courts recognize a "right to cure" and prohibit the awarding of extra-contractual damages for bad-faith lawsuits in order to reduce insurers' incentives to cover up or contest minor technical errors).

9. *See, e.g.*, Goddard v. Farmers Ins. Co., 179 P.3d 645 (Or. 2008) (affirming a $20 million punitive damage award for bad-faith insurer practice); *see also, e.g.*, *$20 Million Allstate Ruling*, CHI. TRIB., Oct. 14, 2006, § 2, at 2 ($18 million punitive damages verdict against insurer); David Harper, *Lawyer: Suits Not About Big Money*, TULSA WORLD, Jan. 7, 2007, at A18 ($10 million punitive damages verdict against insurer for bad-faith handling of claim); Dan Margolies, *A Look At What's Behind Area's Big Jury Awards*, KAN. CITY STAR, Jan. 16, 2007, at D11 ($10.5 million punitive damage award against insurer in first-party bad-faith case).

10. *See* Clausen v. Nat'l Garage Mut. Ins. Co., 730 A.2d 133, 140 (Del. Super. Ct. 1997) ("Actions seeking recovery for bad faith under first-party medical, disability, casualty, and life policies are a relatively recent development and an increasingly common cause of action."); *see also* Alan O. Sykes, *Bad Faith Breach of Contract By First-Party Insurers*, 25 J. LEGAL STUD. 405, 406 (1996) (explaining the recent rise in bad-faith insurance actions and the increase in their remedies); *supra* note 1 and accompanying text (emphasizing the rapid increase in bad-faith insurance claims).

11. *See* H.B. 1407, 2008 Leg., 66th Sess. (Colo. 2008) (codified at COLO. REV. STAT. § 10-3-1115 to -1116 (2008)); S.B. 389, 2007 Leg., Reg. Sess. (Md. 2007) (codified at MD. CODE ANN. INS. § 27-1001 (2007)); S.B. 2822, 2008 Leg., 85th Sess. (Minn. 2008) (codified at MINN. STAT. § 604.18 (2008)); S.B. 5726, 2007 Leg., 60th Sess. (Wash. 2007) (codified at WASH. REV. CODE § 48.30.015 (2007)).

expanding their bad-faith laws.[12] While arguments can be made that such amendments are not necessary, and that the adaptability of the common law is sufficient to protect insureds, the fact remains that bad-faith statutes are a reality in our legal system. As this Article demonstrates, often times these statutes and the related common law are more than sufficient, to the point of being detrimental to the fundamental goal of guaranteeing that insurers do not take advantage of their insureds.

It is in this vein that this Article proposes to balance the scale by providing principles for the reasonable construction of bad-faith and unfair claims settlement practices in statutes applicable to insurance.[13] Part I examines the history and development of bad-faith law, and discusses the common structure of statutes giving rise to bad-faith settlement claims. Part II presents general principles courts may apply to resolve an action alleging bad faith, and specific principles courts may apply to address common issues with many states' statutes. Part III then evaluates the public policy involved in applying such principles to first-party claims where the insured suffers an injury and seeks compensation directly from the insurance company, or, where they are permitted, third-party claims where the insured harms a person not party to the insurance contract and the harmed person makes a claim against the insured who is then defended by the insurer.[14]

This Article concludes that the public interest is most effectively and efficiently served by applying more responsible construction of bad-faith laws and by returning to the foundational precepts behind these laws. It further reasons that while there is, no doubt, a substantial public interest in ensuring that insurers "play nicely" and act in good faith, this interest should not always be enforced through litigation and should never supersede basic fairness and justice.

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12. In 2009, state jurisdictions introduced the following bad-faith bills: S.B. 103, 2009 Leg., 67th Sess. (Colo. 2009); S.B. 763, 2009 Leg., Reg. Sess. (Conn. 2009); S. 962, 2009 Leg., Reg. Sess. (Fl. 2009); H.B. 450, 2009 Leg., Reg. Sess. (Ga. 2009); S.B. 1137, 2009 Leg., Reg. Sess. (Iowa 2009); L.D. 1305, 2009 Leg., 124th Sess. (Me. 2009); H.B. 345, 2009 Leg., 61st Sess. (Mont. 2009); S.B. 157, 2009 Leg., Reg. Sess. (N.M. 2009); A.B. 224, 2009 Leg., Reg. Sess. (Nev. 2009); S. 132, 2008–09 Leg., 213th Sess. (N.J. 2008); A. 3698, 2009 Leg., Reg. Sess. (N.Y. 2009); H.B. 2791, 2009 Leg., Reg. Sess., 75th Sess. (Or. 2009); S.B. 746, 2009 Leg., Reg. Sess. (Pa. 2009); H. 5196, 2009 Leg., Reg. Sess. (R.I. 2009); B. 18-103, 2009 Leg., Reg. Sess. (D.C. 2009).

13. *See generally* Victor E. Schwartz & Phil Goldberg, *The Law of Public Nuisance: Maintaining Rational Boundaries on a Rational Tort*, 45 WASHBURN L.J. 541, 561–82 (2006) (developing reasonable construction principles in the law of public nuisance).

14. This Article does not differentiate between first-party and third-party tort liability, but rather uses the general term "claimant" to refer to whoever is lawfully permitted to bring a claim.

Finally, this Article suggests that courts apply the principles discussed where a statute does not clearly and unambiguously express a contrary interpretation or where doing so would subvert the public's interest in safeguarding consumers from oppressive insurer acts.

I. LANDSCAPE OF BAD-FAITH CLAIMS

A. *History and Development of Bad Faith*

The history of the law pertaining to bad faith is deeply entwined with the practice of insurance. Nearly a century ago, the New York Court of Appeals in *Brassil v. Maryland Casualty Co.*[15] first recognized an implied contractual duty of "good faith and fair dealing" in every insurance agreement.[16] Over a half century later, the Supreme Court of California held that "bad" insurer acts provide a basis to look beyond the traditional contract measure of damages and create common law tort liability.[17] Today, this liability is often determined by statute and insurance practices continue to dominate the litigation landscape.[18]

Before courts recognized tort liability for bad faith, and before states began to comprehensively regulate insurance practices, insurers had greater latitude to act.[19] In some instances, insurers, or perhaps more appropriately, their employees or agents, took advantage of an insured's lack of remedies to limit, delay, or even deny recovery.[20] The primary remedy for claims made against an insurer during this period was determined by the common law rule of *Hadley v. Baxendale*,[21] which limited damages to the terms of a

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15. 104 N.E. 622 (N.Y. 1914).

16. *Id.* at 624; *see also* Hilker v. W. Auto. Ins. Co., 231 N.W. 257, 261 (Wis. 1930), *aff'd on reh'g*, 235 N.W. 413, 414 (Wis. 1931) (relying on *Brassil* and noting that the term "bad faith" is one of variable significance and broad application).

17. *See supra* note 6 and accompanying text (noting that attorneys handling insurance policy claims often seek out bad faith to heighten available recoveries).

18. *See supra* note 1 (acknowledging the emergence of bad-faith claims against insurance companies).

19. *See* ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 7.7 (1988) (explaining that before the emergence of bad-faith laws, insurers were generally not penalized for purposeful delay in paying a claim or a failure to pay); Roger Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. MICH. J. L. REFORM 1, 11–12 (1992) (describing insurers' freedom from liability for legal fees or penalties before the enactment of statutes that protected consumers from unjustified refusals to pay claims).

20. *See, e.g.*, Ins. Co. v. Piaggio, 83 U.S. 378, 386 (1872) (limiting damages to the insurance policy agreement plus interest).

21. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

contract.[22] Outside of the contract, recovery against an insurer was primarily limited to a fraud action, which required a showing that the insurer never intended to perform the agreement, or an action for intentional infliction of emotional distress, which did not always cover economic damages and was not uniformly available across state jurisdictions.[23] Some states also provided a statutory action to recover attorneys' fees and sometimes penalties or interest for unnecessary delays in payment.[24] However, the practical difficulties of proving fraud, the non-uniform availability of other remedies, and the lack of well-developed regulatory oversight or significant penalties for insurer violations disadvantaged claimants who challenged a specific insurer's actions.

Beginning in the 1950s, courts first began to impose an extra-contractual duty to settle so-called "third-party" claims that arose when the insured was sued for wrongfully harming another person.[25] This duty covered situations where an "insurer had rejected a settlement offer within the policy limits and the insured thereafter incurred liability in excess of those limits,"[26] thus leaving the insured with the obligation to fund the excess amount owed to the third party out-of-pocket. The Supreme Court of California in *Comunale v. Traders & General Insurance Co.*[27] became the first court of last resort to hold the insurer, and not the insured, liable for such excess damages as a breach of the insurer's implied covenant of good faith and fair dealing.[28] As the court explained, "An insurer who denies

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22. *See id.* at 151 (limiting damages to those contingencies within the mutual contemplation of the parties at the time of the contract).

23. *See* STEPHEN ASHLEY, BAD FAITH ACTIONS: LIABILITY AND DAMAGES § 2.11, at 2-32, 2-33 (2d ed. 1997); *see also* H. Walter Croskey, *Bad Faith in California: Its History, Development and Current Status*, 26 TORT & INS. L.J. 561, 561–63 (1991) (tracing the development of tort remedies for bad-faith insurance claims in California); Marc S. Mayerson, *"First Party" Insurance Bad Faith Claims: Mooring Procedure to Substance*, 38 TORT TRIAL & INS. PRAC. L.J. 861, 864 (2003) (discussing the elements of fraud and intentional infliction of emotional distress claims that make such claims difficult or undesirable to bring).

24. *See* Henderson, *supra* note 19, at 12 n.39 (listing various state statutes enacted at the turn of the century that allowed for recovery of attorneys' fees and penalties); *see also id.* at 13 (indicating that while some states adopted statutes to allow recovery for attorneys' fees, the majority of states did not adopt similar legislation).

25. Browne et al., *supra* note 1, at 360–81; Dominick C. Capozzola, *First-Party Bad Faith: The Search for a Uniform Standard of Culpability*, 52 HASTINGS L.J. 181, 185–86 (2000) (discussing the emergence in Comunale v. Traders & General Insurance Co., 328 P.2d 198 (Cal. 1958), of a duty to settle claims in excess of policy limits).

26. Sykes, *supra* note 10, at 406.

27. 328 P.2d 198 (Cal. 1958).

28. *See id.* at 201 ("When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement . . . [the insurer's] unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.").

coverage does so at its own risk, and, although its position may not have been entirely groundless, if the denial is found to be wrongful it is liable for the full amount which will compensate the insured . . . ."[29]

In 1973, fifteen years after *Comunale*, the Supreme Court of California once again engineered the development of the law of bad faith in *Gruenberg v. Aetna Insurance Co.*[30] by extending tort liability to so-called "first party" claims where an insured sues his or her insurer under a liability coverage agreement.[31] The court in *Gruenberg* built on third-party jurisprudence[32] and a line of California appellate court rulings that supported first-party tort liability,[33] ultimately reasoning that "[t]hese are merely two different aspects of the same duty."[34] In that case, the "bad faith" was also readily apparent. The insurer "willfully and maliciously" engaged in a scheme to deprive an insured of benefits from a fire insurance policy by encouraging criminal charges by falsely implying that the insured had a motive to commit arson.[35] The insured was unable to appear for an examination while the criminal charges were pending, and the insurer intended to use the insured's failure to appear as a pretense for denying liability.[36]

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29. *Id.* at 202.
30. 510 P.2d 1032 (Cal. 1973).
31. *See id.* at 1037 (holding that an insurer may be liable in tort for failing to compensate insured).
32. *See, e.g.*, *Comunale*, 328 P.2d at 201 (distinguishing insurance companies' duty to compensate third parties (which is limited to the policy amount) from insurance companies' duty to insureds (first parties) for insurance company breach of contract); *see also, e.g.*, Crisci v. Sec. Ins. Co., 426 P.2d 173, 178 (Cal. 1967) (affirming judgment of emotional damages for third-party plaintiff against insurer).
33. The California Court of Appeal case, *Wetherbee v. United Insurance Co.*, 71 Cal. Rptr. 764 (Ct. App. 1968), *aff'd* 95 Cal. Rptr. 678 (Ct. App. 1971), appears to be the first to permit extra-contractual damages in the first-party insurance context. *See id.* at 767 (insured under disability policy awarded $500,000 punitive damages and $1,050 compensatory damages relating to claim for $150 in monthly benefits). Two years later, the Court of Appeal affirmed after remittitur, punitive and compensatory damages for an insurer's intentional infliction of emotional distress resulting from the insurer's wrongful refusal to pay the insured's disability claim, and stated that independent of that tort, the threatened and actual bad faith acts constituted a "tortious interference to a protected property interest." Fletcher v. Western Nat'l Life Ins. Corp., 89 Cal. Rptr. 78 (Ct. App. 1970). In 1972, the court similarly relied upon this theory to justify a punitive damage award in an uninsured motorist case. *See* Richardson v. Employers Liab. Assurance Corp., 102 Cal. Rptr. 547 (Ct. App. 1972), *overruled on other grounds by Gruenberg*, 510 P.2d at 1042 n.10; *see also* Kelly H. Thompson, Comment, *Bad Faith: Limiting Insurers' Extra-Contractual Liability in Texas*, 41 Sw. L.J. 719, 719 (1987) ("California pioneered the development of insurers' extra-contractual liability . . . .").
34. *Gruenberg*, 510 P.2d at 1037.
35. *See id.* at 1038 (noting that the plaintiff alleged that the defendants conspired to encourage criminal charges against the plaintiff by wrongly implying that the plaintiff had a motive to commit arson).
36. *Id.* at 1038.

Following the *Comunale* and *Gruenberg* decisions, courts in other states applied similar reasoning to recognize tort liability for bad faith in both first-party and third-party claims.[37] Because these seminal decisions involved different types of "bad" acts—a manifestly unfair act in *Comunale* and an intentional act in *Gruenberg*—and because the court in *Gruenberg* did not expressly state that intent was required, courts struggled with the degree of culpability needed to maintain this newly established tort.[38] In 1978, the Wisconsin Supreme Court in *Anderson v. Continental Insurance Co.*[39] provided a more definitive and widely-accepted standard that there must be "an absence of a reasonable basis for denial of policy benefits *and* the knowledge or reckless disregard of a reasonable basis for a denial."[40] The court further explained that "the tort of bad faith is not a tortious breach of contract. It is a separate intentional wrong, which results from a breach of duty imposed as a consequence of the relationship established by contract."[41] The court also recognized that the absence of an intent element would allow claimants to "scar[e] insurers into paying questionable claims because of the threat of a bad faith suit."[42]

As the common law basis for the tort of bad faith solidified and, in the case of first-party claims, was adopted by a majority of states in the

37. *See, e.g.*, State Farm Fire & Cas. Co. v. Nicholson, 777 P.2d 1152, 1156 n.6 (Alaska 1989) (allowing an action in tort for breach of good faith and fair dealing in insurance contracts due to the unequal bargaining power of insurers and insureds); Chavers v. Nat'l Sec. Fire & Cas. Co., 405 So. 2d 1, 6 (Ala. 1981) (refusing to allow insurers to deny claims in bad faith, where insurers know "that the avowed purpose of the insurance contract [i]s to protect the insured at his weakest and most perilous time of need"). A number of states that expressly rejected a common law cause of action for bad faith in first-party claims permit third-party actions. *See, e.g.*, Johnson v. Fed. Kemper Ins. Co., 536 A.2d 1211, 1212–13 (Md. Ct. Spec. App. 1988); Duncan v. Andrew County Mut. Ins. Co., 665 S.W.2d 13, 18–19 (Mo. Ct. App. 1983); Lawton v. Great Sw. Fire Ins. Co., 392 A.2d 576, 581 (N.H. 1978); Beck v. Farmers Ins. Exch., 701 P.2d 795, 799 (Utah 1985).

38. The *Gruenberg* decision did not explicitly state that a willful or malicious act was necessary to maintain a first-party bad-faith claim in tort. Rather, the court only required an unreasonable act. *See* Jason C. Brown, *Extra-Contractual Damages Stemming from a First-Party Insurer's Bad Faith Breach: Will Minnesota Adopt the Tort or Contract Theory of Recovery?*, 26 WM. MITCHELL L. REV. 525, 534 (2000) (noting a consensus by scholars that *Gruenburg*'s holding is vague and gives little guidance).

39. 271 N.W.2d 368 (Wis. 1978).

40. *Id.* at 377 (emphasis in original); *cf.* Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987) (articulating the same reasonable basis and actual knowledge standard). *But see* Lee Shidlofsky, *The Changing Face of First-Party Bad Faith Claims in Texas*, 50 SMU L. REV. 867, 872 (1997) (discussing the weaknesses of the test announced in *Arnold*).

41. *Anderson*, 271 N.W.2d at 374; *see also* State Farm Fire & Cas. Co. v. Simpson, 477 So. 2d 242, 250 (Miss. 1985) (stressing that a bad-faith refusal claim is an "independent tort").

42. *Anderson*, 271 N.W.2d at 377 (quoting John W. Thornton & Milton S. Blaut, *Bad Faith and Insurers: Compensatory and Punitive Damages*, 12 TORT TRIAL & INS. PRAC. L.J. 699, 719 (1977)).

1970s and 1980s,[43] many states also moved towards statutory codification.[44] State legislatures often set out to protect against insurer bad faith by enumerating unfair practices or, at least, by providing plaintiffs with a statutory bad-faith comparison when initiating a common law action.[45] The law of bad faith began to follow an unsteady and precarious path during this period.[46] Although the state legislatures enacted statutes in an attempt to instill greater definition and support to bad-faith law, some statutes have blunted the willfulness, maliciousness, or manifest injustice that provided the foundation of this new tort action in the first place. The idea of inherent unfairness of specific acts has been lost in certain instances and, instead, has been replaced with nebulous elements that have been manipulated to enhance outcomes.

43. State supreme court decisions expanding bad-faith tort actions to first-party claimants during this period include: Chavers v. Nat'l Sec. Fire & Cas. Co., 405 So. 2d 1 (Ala. 1981); State Farm Fire & Cas. Co. v. Nicholson, 777 P.2d 1152 (Alaska 1989); Aetna Cas. & Sur. Co. v. Broadway Arms Corp., 664 S.W.2d 463 (Ark. 1984); Travelers Ins. Co. v. Savio, 706 P.2d 1258 (Colo. 1985); Buckman v. People Express, Inc., 530 A.2d 596 (Conn. 1987); White v. Unigard Mut. Ins. Co., 730 P.2d 1014 (Idaho 1986); Dolan v. Aid Ins. Co., 431 N.W.2d 790 (Iowa 1988); Curry v. Fireman's Fund Ins. Co., 784 S.W.2d 176 (Ky. 1989); State Farm Fire & Cas. Co. v. Simpson, 477 So. 2d 242 (Miss. 1985); Lipinski v. Title Ins. Co., 655 P.2d 970 (Mont. 1982); Braesch v. Union Ins. Co., 464 N.W.2d 769 (Neb. 1991); United Fire Ins. Co. v. McClelland, 780 P.2d 193 (Nev. 1989); State Farm Gen. Ins. Co. v. Clifton, 527 P.2d 798 (N.M. 1974); Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638 (N.D. 1979); Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315 (Ohio 1983); Christian v. Am. Home Assurance Co., 577 P.2d 899 (Okla. 1977); Bibeault v. Hanover Ins. Co., 417 A.2d 313 (R.I. 1980); Nichols v. State Farm Mut. Auto. Ins. Co., 306 S.E.2d 616 (S.C. 1983); Champion v. U.S. Fid. & Guar. Co., 399 N.W.2d 320 (S.D. 1987); Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165 (Tex. 1987); and Anderson v. Cont. Ins. Co., 271 N.W.2d 368 (Wis. 1978). States continued to recognize first-party bad-faith suits into the 1990s. *See* Tackett v. State Farm Fire & Cas. Ins. Co., 653 A.2d 254 (Del. 1995); Best Place, Inc. v. Penn Am. Ins. Co., 920 P.2d 334 (Haw. 1996); Erie Ins. Co. v. Hickman, 622 N.E.2d 515 (Ind. 1993); Marquis v. Farm Family Mut. Ins. Co., 628 A.2d 644 (Me. 1993); McCullough v. Golden Rule Ins. Co., 789 P.2d 855 (Wyo. 1990). *See generally* Browne et al., *supra* note 1, at 355; Capozzola, *supra* note 25, at 182; Goldberg et al., *supra* note 6, at 727; A.S. Klein, Annotation, *Insurer's Liability for Consequential or Punitive Damages for Wrongful Delay or Refusal to Make Payments Due Under Contracts*, 47 A.L.R.3d 314 (1992).

44. *See* Mayerson, *supra* note 22, at 863 n.6 (2003) (discussing state level, non-judicially promulgated standards and rules for insurance company conduct).

45. *See infra* notes 120–121 (exploring the influence of statutes in adjudication and on the common law).

46. *See* Henderson, *supra* note 19, at 32 (arguing that while "the new tort remedy [is] necessary in some form, [it] now shows signs of being too oppressive on an industry whose financial vitality and efficiency are essential to social well-being").

B. Bad-Faith Statutes

Today, statutes addressing bad-faith and unfair insurance claims settlement practices exist, in some form, in every state.[47] These laws are largely a product of model legislation drafted by the National Association of Insurance Commissioners (NAIC) in the early 1970s.[48] The NAIC's model legislation covered unfair methods of competition and general deceptive practices in the insurance business.[49]

47. *See* ALA. CODE § 27-12-24 (LexisNexis 2007); ALASKA STAT. § 21.36.125 (2008); ARIZ. REV. STAT. ANN. § 20-461 (2002); ARK. CODE ANN. § 23-66-206 (2001); CAL. INS. CODE § 790.03(h) (West 2005); COLO. REV. STAT. § 10-3-1104(1)(h), 10-3-1115 to -1116 (2008); CONN. GEN. STAT. § 38A-816(6) (West 2007); DEL. CODE ANN. tit. 18, § 2304(16) (2009); FLA. STAT. ANN. §§ 624.155(1) (West 2004), 626.9541(1)(i) (West 2009), 766.1185 (West 2003); GA. CODE ANN. § 33-6-34 (2000); HAW. REV. STAT. ANN. § 431:13-103(a) (LexisNexis 2008); IDAHO CODE ANN. § 41-1329 (2003); 215 ILL. COMP. STAT. ANN. 5/154.6, 5/155 (West 2000); IND. CODE ANN. § 27-4-1-4.5 (LexisNexis 1999); IOWA CODE ANN. § 507B.4(9) (West 2007); KAN. STAT. ANN. § 40-2404(9) (2000); KY. REV. STAT. ANN. § 304.12-230 (2009); LA. REV. STAT. ANN. § 22:1220, 22:1973 (2004); ME. REV. STAT. ANN. tit. 24-A, §§ 2164-D, 2436-A (2000); MD. CODE ANN. INS. § 27-303 to -305, 27-1001 (LexisNexis 2006); MASS. ANN. LAWS ch. 93A, § 9, ch. 176D, § 3 (LexisNexis 2005); MICH. COMP. LAWS SERV. § 500.2026 (LexisNexis 2008); MINN. STAT. § 72A.20(12), 72A.201, 604.18; MO. REV. STAT. § 375.1007 (West 2002); MONT. CODE ANN. §§ 33-18-201, 33-18-242 (2007); NEB. REV. STAT. § 44-1540 (2004); NEV. REV. STAT. § 686A.310 (2007); N.H. REV. STAT. ANN. § 417:4(XV) (2006); N.J. STAT. ANN. § 17B:30-13.1 (West 2006); N.M. STAT. ANN. § 59A-16-20 (LexisNexis 2000); N.Y. INS. LAW § 2601 (McKinney Supp. 2009); N.C. GEN. STAT. §§ 58-63-15(11), 75-1.1 to -16 (2007); N.D. CENT. CODE § 26.1-04-03(9) (2002); OHIO REV. CODE ANN. § 3901.21(P) (LexisNexis Supp. 2009); OKLA. STAT. ANN. tit. 36, § 1250.4–.5 (West 1999 & Supp. 2009); OR. REV. STAT. § 746.230 (2007); 40 PA. CONS. STAT. § 1171.5(a)(10) (1999); 42 PA. CONS. STAT. § 8371 (West 2007); R.I. GEN. LAWS §§ 9-1-33 (1997), 27-9.1-4 (2008); S.C. CODE ANN. § 38-59-20 (2002); S.D. CODIFIED LAWS § 58-33-67 (2002); TENN. CODE ANN. § 47-18-109, 56-7-105, 56-8-104(8) (2008); TEX. INS. CODE ANN. § 542.003 (Vernon 2009); UTAH CODE ANN. § 31A-26-303 (2005); VT. STAT. ANN. tit. 8, § 4724(9) (2) (2005); VA. CODE ANN. § 38.2-510 (2007); WASH. REV. CODE ANN. § 48.30.015 (Supp. 2009); WASH. ADMIN. CODE § 284-30-330 (2009); W. VA. CODE R. ANN. §§ 33-11-4(9), 33-11-4a (2006); WYO. STAT. ANN. § 26-13-124 (2007). Mississippi and Wisconsin do not appear to have statutes specific to insurance bad-faith or unfair claims settlement practices, but do generally prohibit unfair or deceptive insurance practices and set forth time periods in which claims must be paid. *See* MISS. CODE ANN. §§ 83-5-33, -45, 83-9-5 (1999 & Supp. 2008); WIS. STAT. ANN. §§ 424.501, 628.46 (West 2004 & 2005). *But see* Kontowicz v. Am. Standard Ins. Co., 714 N.W.2d 105, 115 (Wis. 2006) (stating that the statute relating to the timely payment of insurance claims was unrelated to the tort action of bad faith).

48. NAIC originally promulgated the Model Unfair Trade Practices Act (MUTPA) in the 1950s with provisions for the regulation of insurer unfair trade practices, and all states had adopted it by 1959. *See* KEETON & WIDISS, *supra* note 19, § 8.1, at 932–34; Henderson, *supra* note 19, at 14. However, the original model act mainly dealt with the marketing practices of insurers. New model legislation dealing with unfair claims settlement practices was developed and incorporated into the MUTPA by amendment in 1972. Proceedings of the National Association of Insurance Commissioners 495 (1972) [hereinafter Proceedings].

49. Proceedings, *supra* note 49, at 495–96.

In tailoring statutes specific to claims settlement practices, a majority of states have adopted this legislation with only minor changes.[50]

The core provisions of such statutes are general and justifiably broad in scope. For example, there is a near uniform provision that requires insurers to communicate "reasonably promptly" with respect to claims, and the requirement to adopt and implement "reasonable standards" for claims investigation.[51] This requirement is often supplemented by an obligation to affirm or deny a claim within a "reasonable time."[52] These statutes typically contain a prohibition against refusing to pay claims without a "reasonable investigation," and the essential duty to negotiate "in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear."[53] Many statutes also contain provisions prohibiting insurers from "[c]ompelling insureds to institute litigation . . . by offering substantially less than the amounts ultimately recovered" when an insured makes a claim.[54]

In essence, these general provisions cover insurer actions that are unreasonable, but not necessarily intentional. They are included among more specific prohibited acts that imply an element of intent. For example, most unfair claims settlement statutes also prohibit insurers from: attempting to settle claims where the insurer altered a claims application without notice or consent of the insured; making payments to insureds or beneficiaries without stating the coverage under which the payments were being made; delaying investigation or payment of a claim by requiring submission of preliminary claims

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50. The states adopting NAIC's model legislation near wholesale include: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, North Dakota, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Washington, West Virginia, and Wyoming. *See, e.g.*, Knotts v. Zurich Ins. Co., 197 S.W.3d 512, 528 (Ky. 2006) (stating that Kentucky's Unfair Claims Settlement Practices Act was enacted almost verbatim from the NAIC model act and that the act has been adopted in varying forms in all fifty states and U.S. territories). Other states have adopted nearly identical language for less substantial portions of their unfair claims settlement statutes. These states include Mississippi, New Mexico, Oklahoma, South Dakota, Texas, and Utah. *See, e.g.*, Lewis v. Equity Nat'l Life Ins. Co., 637 So. 2d 183 (Miss. 1994) (stating that Mississippi's unfair claims settlement act was based from model NAIC legislation drafted in 1976).

51. *See, e.g.*, IDAHO CODE ANN. § 41-1329 (2003) (adopting the model legislation without significant modification or additional claims settlement provisions).

52. *Id.*

53. *Id.*

54. *Id.*; *see also infra* Part II.B.4 (arguing that claims settlement statutes that compare the insurer's final settlement offer to the amount recovered represent unsound policy).

reports with duplicative information; and intimidating claimants by making them aware of an insurer's policy of appealing any arbitration award favorable to the insured.[55]

Despite the commonality in structure and language of most of the unfair claims settlement practices state statutes, judicial interpretation of these laws varies significantly. The combination of unreasonable insurer acts and intentional acts within the statutes provides some explanation for divergent interpretations. Because these statutes are largely based on model legislation that predates the prevailing common law developments with respect to the degree of culpability necessary to maintain an action,[56] the statutes fail to clearly identify bad-faith settlement practices as an intentional tortious act. Thus, less culpable conduct, including that of mere negligence, may trigger a statutory bad-faith violation even where it would be inappropriate under the state's common law.[57] Such amorphous and inconsistent treatment has encouraged allegations of bad faith in insurance litigation, even in cases where the insurer and the insured simply disagree, or for other non-negligent conduct.

Inconsistent state interpretations also exist as to the manner of enforcement—specifically, whether private or public actors should enforce bad-faith statutes. Some states have codified the common law bad-faith cause of action expressly and thereby allow private enforcement,[58] while other states expressly retain exclusive oversight

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55. *See* statutes cited *supra* note 47.

56. *See supra* notes 38–41 and accompanying text (tracing the development of the level of culpability required in a bad faith tort claim).

57. *Compare* COLO. REV. STAT. ANN. § 10-3-1113 (2008) (stating a negligence standard for first-party claims against an insurer), *with* Travelers Ins. Co. v. Savio, 706 P.2d 1258, 1272 (Colo. 1985) (articulating a two-element standard for insurer conduct: "unreasonable conduct, and knowledge that the conduct is unreasonable or a reckless disregard for the fact that the conduct is unreasonable").

58. *See, e.g.*, COLO. REV. STAT. ANN. § 10-3-1113 (2008) (explaining that an insurer has breached its duty of good faith if it has unreasonably delayed or denied payment, and providing guidelines for civil actions based on such a breach); FLA. STAT. ANN. § 624.155(1) (West 2004) (allowing any person damaged to bring a civil action against an insurer); GA. CODE ANN. § 33-4-7 (West 2000) (permitting a claimant to initiate a civil action based on bad faith only after the claimant has attempted to settle with the insurer); LA. REV. STAT. ANN. § 22:1220 (2008) (listing several specific acts that constitute a breach of the insurer's duty of good faith when knowingly committed); 42 PA. CONS. STAT. ANN. § 8371 (West 2007) (explaining the various remedies available under a private bad-faith cause of action against an insurer); R.I. GEN. LAWS § 9-1-33 (2005) (allowing a claimant to recover compensatory and punitive damages, as well as attorneys' fees, against an insurer that refuses to pay or settle a claim in bad faith); WASH. REV. CODE ANN. § 48.30.015 (2007) (requiring an unreasonable denial of benefits by an insurer before a claimant may bring a private action); *see also* Goldberg et al., *supra* note 6, at 731 (noting that many of these statutes serve as the legislatures' response to a state judicial branch not recognizing a common law claim against insurers for bad faith).

and enforcement through the state insurance commissioner.[59] In some states, the judiciary has also created an implied private right of action on the basis of a bad-faith statute.[60] Other state courts have taken the opposite approach and have held that bad-faith statutes preempt private enforcement.[61] Even where a private statutory right

59. *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-461(19)(D) (West Supp. 2004) (noting that although the unfair claims settlement practices statute provides a right to an administrative remedy, it does not provide any private right of action for insureds); ME. REV. STAT. ANN. tit. 24-A, § 2164-D(8) (2000) (noting that the state's unfair claims practices section may not be construed to provide a private cause of action); S.D. CODIFIED LAWS § 58-33-69 (2005) (barring private actions under the state's unfair or deceptive insurance practices laws); TENN. CODE ANN. § 56-8-101 (2008) (granting the state insurance commissioner sole enforcement authority for, and barring any private right of action under, the Tennessee Unfair Trade Practices and Unfair Claims Settlement Act); UTAH CODE ANN. § 31A-26-303 (2005) (listing what acts constitute unfair claims settlement practices, but explicitly barring a private cause of action based on such acts).

60. *See* Lees v. Middlesex Ins. Co., 643 A.2d 1282, 1286 (Conn. 1994) (implying a private right of action for violation of the Unfair Insurance Practices Act in cases where the insurer's action rises to the level of a general business practice); Curry v. Fireman's Fund Ins. Co., 784 S.W.2d 176, 178 (Ky. 1989) (implying a right of action for first-party claimants based, in part, on a public policy argument for the advantages of permitting recovery when an insurer acts in bad faith); State Farm Mut. Auto Ins. Co. v. Reeder, 763 S.W.2d 116, 117–18 (Ky. 1988) (reasoning that a third-party private right of action was permissible, because the insurer had clearly violated the Unfair Claims Settlement Practice Act and the Act did not specifically prohibit such a claim); Dodd v. Commercial Union Ins. Co., 365 N.E.2d 802, 805 (Mass. 1977) (holding that the legislature's failure to specifically provide for a private right of action under the state consumer protection act does not demonstrate an intent to prohibit such a claim), *superseded by statute*, MASS. GEN. LAWS ch. 93A, § 9(1) (2002), *as recognized in* Hershenow v. Enter. Rent-A-Car Co., 840 N.E.2d 526, 532 (Mass. 2006); Indus. Indem. Co. of N.W. v. Kallevig, 792 P.2d 520, 530 (Wash. 1990) (finding that the plain language of the Washington State Consumer Protection Act supported an insured's private bad-faith cause of action against an insurer). In *Royal Globe Insurance Co. v. Superior Court*, 592 P.2d 329, 332 (Cal. 1979), the California Supreme Court was the first to hold that a private cause of action existed for a violation under its version of the model NAIC legislation, but reversed itself almost a decade later. *See* Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58, 68 (Cal. 1988) (arguing that the *Royal Globe* decision was based primarily on public policy, and that resolutions based on competing policy issues are more properly addressed by the legislature). West Virginia also initially implied a private right of action in *Jenkins v. J. C. Penney Casualty Insurance Co.*, 280 S.E.2d 252 (W. Va. 1981), but later enacted legislation superseding the decision. *See* W. VA. CODE ANN. § 33-11-4a (LexisNexis 2006) (abrogating a private cause of action relating to bad-faith settlements of insurance claims). Conversely, in Montana, an implied right of action was superseded by a statute that allowed private enforcement. *See* Klaudt v. State Farm Mut. Auto. Ins. Co., 658 P.2d 1065, 1067 (Mont. 1983) (finding that the statutory language on its face clearly protected third-party claims), *superseded by statute*, Unfair Trade Practices Act, MONT. CODE ANN. § 33-18-242 (2007), *as recognized in* O'Fallon v. Farmers Ins. Exch., 859 P.2d 1008, 1014–15 (Mont. 1993) (noting that the new law was more permissive because, to allow for a private right of action, it did not require violations of the code to be so frequent as to rise to a general business practice).

61. *See* Spencer v. Aetna Life & Cas. Ins. Co., 611 P.2d 149, 158 (Kan. 1980) (finding that the legislature provided multiple detailed alternative remedies, including those related to bad faith on the part of insurer, for a wronged insured); Lawton v. Great S.W. Fire Ins. Co., 392 A.2d 576, 581 (N.H. 1978) (noting that the

of action is recognized, a number of state courts have found that this action is only available to those insured and not other third-party claimants.[62] Further, in those states where no private statutory right of action exists, some courts have nevertheless found that unfair claims settlement statutes were useful proxies for identifying instances of bad faith in private actions brought under the common law.[63]

In addition to state-by-state differences as to who may bring a statutory bad-faith action against an insurer, there is significant variation in what a successful plaintiff may recover. Some claims settlement statutes specifically provide for attorneys' fees or they set forth damage ranges for each violation of the statute.[64] For example, Oklahoma imposes a fine, enforced by the state Insurance Commissioner, between $100 and $5,000 for each violation of its

legislature established alternative mechanisms to handle insurer malfeasance); D'Ambrosio v. Penn. Nat'l Mut. Cas. Ins. Co., 431 A.2d 966, 970 (Pa. 1981) (reasoning that allowing a private cause of action in addition to the enforcement mechanisms available to the Pennsylvania Insurance Commissioner would require the court to improperly delve into policy issues), *superseded by statute*, 42 PA. CONS. STAT. § 8371 (2007); *cf.* Farris v. U.S. Fid. & Guar. Co., 587 P.2d 1015, 1020 (Or. 1978) (explaining that although the need for private enforcement based on bad faith might arise in extraordinary circumstances, traditional contract remedies are almost always adequate for insurance cases).

62. *See, e.g.*, Bates v. Allied Mut. Ins. Co., 467 N.W.2d 255, 258 (Iowa 1991) (arguing that the adversarial nature of the relationship between the insurer and a third-party claimant, unlike the fiduciary relationship between an insurer and the insured does not provide a basis for a good-faith duty to settle a claim); Dvorak v. Am. Family Mut. Ins. Co., 508 N.W.2d 329, 331 (N.D. 1993) (explaining that an insurer's duty to settle in good-faith extends only to insureds, because, unlike third parties, insureds are direct beneficiaries of the insurer's actions); *Kallevig*, 792 P.2d at 528–30 (holding that the statutory language provides a private right of action for first-party claimants only); Kranzush v. Badger State Mut. Cas. Co., 307 N.W.2d 256, 265 (Wis. 1981) (arguing that a bad-faith tort claim, while distinct from a breach of contract claim, still arises from the insurance contract and therefore only extends to the insured).

63. *See, e.g.*, Wailua Assocs. v. Aetna Cos. & Sur. Co., 27 F. Supp. 2d 1211, 1221 (D. Haw. 1998) (stating that although no private right of action exists under Hawaii's unfair claims settlement statute, it may nevertheless be used as evidence of insurer bad faith in a common law action); *see also* Kontowicz v. Am. Standards, Inc., 714 N.W.2d 105, 114–15 (Wis. 2006) (supporting an unfair claims settlement, in part, with broad statutory principles from case law on bad-faith tort claims).

64. *See, e.g.*, FLA. STAT. ANN. § 624.155(4) (West 2004) (allowing a successful plaintiff to recover damages, court costs, and reasonable attorneys' fees); GA. CODE ANN. § 33-4-6 (2000) (granting the insured limited damages in addition to attorneys' fees and court costs); 215 ILL. COMP. STAT. ANN. § 5/155 (West 1993 & Supp. 2009) (capping the damages available to the insured at sixty percent of the damages, sixty thousands dollars, and/or the excess of the determined damages, not including costs, minus any settlement offered by the insurer); ME. REV. STAT. ANN. tit. 24-A, § 2436-A(1) (allowing a recovery scheme similar to that in Florida, but also providing a monthly interest rate of 1.5 percent on damages).

statute,[65] while Nebraska imposes a penalty up to $30,000 for each and every violation.[66] A number of states also allow punitive damages for private claimants.[67] Massachusetts's bad-faith statute, for instance, expressly permits punitive damages up to twenty-five percent of the underlying bad-faith claim.[68] In comparison, Louisiana uses a

65. *See* OKLA. STAT. ANN. tit. 36, § 1250.14 (West 1994) (exempting the State Insurance Fund).

66. *See* NEB. REV. STAT. § 44-1543 (2004) (capping the total penalty, however, at $150,000).

67. *See, e.g.*, Craft v. Econ. Fire & Cas. Co., 572 F.2d 565, 574 (7th Cir. 1978) (permitting punitive damages in insurance bad-faith claims based on a public interest in preventing insurance companies from abusing their insureds); Trimper v. Nationwide Ins. Co., 540 F. Supp. 1188, 1195 (D. S.C. 1982) (arguing that not allowing punitive damages for bad-faith tort actions would allow insurance companies to operate with impunity); Rodgers v. Penn. Life Ins. Co., 539 F. Supp. 879, 884 (S.D. Iowa 1982) (explaining that a prima facie case for the recovery of punitive damages requires the insured to allege that the insurer acted recklessly and maliciously in denying benefits); German v. N.Y. Life Ins. Co., 501 F. Supp. 51, 53 (N.D. Ill. 1980) (noting that the law does not favor punitive damages); Escambia Treating Co. v. Aetna Cas. & Sur. Co., 421 F. Supp. 1367, 1370–71 (N.D. Fla. 1976) (cautioning that punitive damages are only justified when the defendant is guilty of oppression, fraud, or malice); Fletcher v. W. Nat'l Life Ins. Co., 89 Cal. Rptr. 78, 95 (Cal. Ct. App. 1970) (rejecting arguments that punitive damages are improper and impermissible compensation for intentional infliction of emotional distress); Grand Sheet Metal Prods. Co. v. Prot. Mut. Ins. Co., 375 A.2d 428, 430 (Conn. Super. Ct. 1977) (adopting the Gruenberg rule which states that insurers have a good faith duty to fairly handle claims made by insurers, and that a violation of this duty gives rise to an action in tort); Casson v. Nationwide Ins. Co., 455 A.2d 361, 368 (Del. Super. Ct. 1982) (recognizing a developing trend allowing for recovery of punitive damages against insurers for breach of contract rising to the level of willful, wanton, fraudulent, or malicious conduct); Penn. Millers Mut. Ins. Co. v. Dunlap, 264 S.E.2d 483, 485–86 (Ga. Ct. App. 1980) (explaining that punitive damages should be affirmed unless there was a reasonable legal defense discharging the insurer from its duty of good faith); Linscott v. Rainier Nat'l Life Ins. Co. 606 P.2d 958, 964 (Idaho 1980) (holding that, to receive punitive damages, a plaintiff must show that the insurer's handling of the claim deviated from reasonable standards of conduct with an awareness of the consequences of that deviation); Sacton v. Meridian Mut. Ins. Co., 337 N.E.2d 527, 532 (Ind. Ct. App. 1975) (concluding that punitive damages are appropriate when an insurer heedlessly disregards the consequences of its actions and acts fraudulently or oppressively); First Sec. Bank v. Goddard, 593 P.2d 1040, 1049 (Mont. 1979) (allowing an insured to recover punitive damages based on actual or presumed fraud or malice); Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638, 646 (N.D. 1979) (noting that California and North Dakota statutes require that the insured show that "the insurer acted 'with the intent to vex, injure or annoy, or with a conscious disregard of the plaintiff's rights'" in order to recover punitive damages (quoting Silberg v. Cal. Life Ins. Co., 521 P.2d 1103, 1110 (Cal. 1974)); Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1322 (Ohio 1983) (arguing that mere inaction on behalf of the insurer is not enough to allow an insured to recover punitive damages); Christian v. Am. Home Assur. Co., 577 P.2d 899, 903 (Okla. 1977); Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980); Nichols v. State Farm Mut. Auto. Ins. Co., 306 S.E.2d 616, 620 (S.C. 1983) (explaining that with the recognition of the bad-faith cause of action as a tort, punitive damages may be allowable).

68. *See* MASS. GEN. LAWS ch. 176D, § 7 (2002) (allowing, in addition, non-monetary damages, such as revocation of license for repeat offenders); *see also* MASS. GEN. LAWS ch. 93A, § 9 (2002) (allowing punitive damages for a bad-faith action between two and three times the actual damages).

multiplier and allows exemplary damages up to two times any compensatory recovery.[69]

States that recently amended their bad-faith statutes have also significantly heightened available extra-contractual damages. For example, since 2007, Maryland has increased penalties up to $125,000 per insurer violation,[70] Colorado has authorized aggregate penalties up to $750,000,[71] and Washington has enacted a treble damages multiplier for first-party insurance bad-faith claims.[72]

A final differentiating quality in many claims settlement statutes is the inclusion of additional prohibited acts that are not part of the model NAIC legislation. These provisions often include rigid criteria, such as specific time limits within which an insurer must process a claim, and provide a basis for much of the bad-faith litigation involving less culpable insurers. For example, states like Missouri, Nebraska, and Illinois have statutes prescribing a strict fifteen-day window in which the insurer must provide claims forms or violate the state's unfair claims settlement act.[73] In Rhode Island, that period is ten days.[74] Some states also set strict deadlines for other practices,

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69. *See* LA. REV. STAT. ANN. § 22:1973(C) (2008) (adding that insurers are not permitted to use any punitive damages for setting rates or market-rate filings).

70. *See* S.B. 389, 2007 Leg., Reg. Sess. (Md. 2007) (codified at MD. CODE ANN. INS. § 27-1001 (2007)) (authorizing the state commissioner to impose consequential damages under the bad-faith statute).

71. *See* H.B. 1407, 2008 Leg., 66th Sess. (Colo. 2008) (codified at COLO. REV. STAT. § 10-3-1115 to -1116 (2008)) (providing that the $750,000 cap is the annual limit for aggregate penalties, and further limiting the penalty for a single violation to $3,000).

72. *See* S.B. 5726, 2007 Leg., 60th Sess. (Wash. 2007) (codified at WASH. REV. CODE § 48.30.015 (2007)) (noting that the insured may apply other claims against the insurer based on unfair or deceptive practices, which are not subject to the bill's limits).

73. *See* 215 ILL. REV. STAT. ANN. § 5/154.6(o) (West 2003) (listing various acts which, if committed knowingly, will constitute improper claims practice); MO. REV. STAT. § 375.1007(13) (2002) (requiring further that the insurer include reasonable instructions for the forms' use); NEB. REV. STAT. § 44-1540(14) (2004) (standing alone as the only provision in the section with a specific time limit despite an overall focus on promptness).

74. R.I. GEN. LAWS § 27-9.1-4(13) (2008).

such as when an insurer must respond to a claim[75] or even when a claim must be settled.[76]

Differences in identification of bad-faith conduct, enforcement mechanisms, and remedies create a wide range of treatment for bad faith in the handling of insurance claims. Although most states' statutes appear similar, and sometimes nearly identical in form, their interpretation by courts and the presence of additional provisions or remedies creates close to fifty unique landscapes. It is against this backdrop that courts would benefit from a more reasoned set of principles to apply in addressing bad-faith insurance claims.

II. APPLYING THE RULE OF REASON FOR JUST CONSTRUCTION OF BAD-FAITH LAWS

In delineating principles to assist courts with bad-faith insurance claims, we begin with the most basic inquiry: What is bad faith? Courts and legal scholars have long struggled to form an acceptable answer to this question.[77] The difficulty of reaching a satisfactory definition stems in part from the fact that good faith and bad faith have only recently been independently recognized in tort law.[78] In many respects, bad-faith law is still in its formative years. Rather than attempt to precisely define bad faith, many states, at common law, adopt a "you know it when you see it" approach and leave it for a

75. *See, e.g.*, FLA. STAT. ANN. § 626.9541(1)(i)(3)(e) (West 2004) (requiring an insurer to affirm or deny claims, or communicate that claims are being investigated upon an insured's written request within thirty days after completing proof of loss statements); OKLA. STAT. tit. 36, § 1250.4(C) (1994) (providing that an insurer must respond to all pertinent written communications from the insured within thirty days after receipt); R.I. GEN. LAWS § 27-9.1-4(16) (2008) (allowing the insurer to take longer with the consent of the insured); S.D. CODIFIED LAWS § 58-33-67(1) (2005) (instructing the insurer to adopt standards to promote prompt investigation of claims in addition to the thirty-day response to a claim requirement).

76. *See, e.g.*, CONN. GEN. STAT. § 38a-816(15)(B) (2007) (requiring an insurer to settle claims within forty-five days); N.M. STAT. ANN. § 59A-16-20(F) (West 2008) (characterizing the failure to settle "catastrophic claims" within ninety days as a prohibited unfair claims practice); W. VA. CODE § 33-11-4(9)(o) (2006) (requiring claims to be settled within a ninety-day period).

77. *See* Henderson, *supra* note 19, at 34 ("The term 'bad faith' . . . is not self-defining, nor has it historically been a recognized, independent basis of culpability in tort law. It has come to mean different things to different courts. Consequently, its use has caused definitional problems from the outset."); *see also* King v. Second Nat'l Bank & Trust of Saginaw, Mich., 173 So. 498, 500 (Ala. 1937) ("Bad faith is not to be inferred from facts equally consistent with good faith."); Spencer v. Aetna Life & Cas. Ins. Co., 611 P.2d 149, 151 (Kan. 1980) (describing, critically, the trend towards recognition of the independent tort of bad faith as an attempt to provide a remedy for every wrong).

78. *See supra* Part II.A (highlighting the development of the independent tort of bad faith and concluding that attempts to statutorily define bad faith have only muddled its meaning).

jury to filter out what bad faith really means.[79] Because this practice can lead to inconsistent results, states have moved to codify bad faith through laws such as insurance claims settlement statutes, and, in doing so, have re-encountered the same difficulties and inconsistencies that initially prompted courts to resist more rigid definitions for this highly amorphous concept.[80] The effect of this dual statutory and common law development is that the law of bad faith is now more muddled than ever. To help wade through this disorder and provide rational boundaries for bad faith, this Article proposes a set of general principles applicable to all types of bad-faith insurance claims along with a set of principles applicable to common issues arising under claims settlement statutes.

A. General Principles Applicable to Bad-Faith Claims

1. "Bad Faith" should include a minimum element of intentional or reckless misconduct

The law of bad faith originated in order to combat the "bad acts" of insurers.[81] It was first recognized to prevent insurers from refusing to settle a claim or properly defend an insured against third parties and instead roll the dice at the insured's expense in hopes of being found liable for less than the insured's policy limit.[82] The tort was later recognized in a case involving acts tantamount to fraud where an insurer "willfully and maliciously" schemed to deny coverage to the insured.[83] These origins, whether or not formally expressed at the time, were aimed at countering specific and purposeful insurer acts.[84] They invoked a sense of dishonesty and malice on the part of an

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79. *See* ROBERT H. JERRY, UNDERSTANDING INSURANCE LAW 151 (2d ed. 1996) (explaining that good faith and bad faith have "no universally accepted definition" and, therefore, the trier of fact has "considerable flexibility" in adjudicating cases involving potential mishandling of insurance claims).

80. *See* Capozzola, *supra* note 25, at 182–83 (explaining that attempts to provide a remedy for bad faith have led to insurer culpability standards that vary widely from state to state).

81. *See supra* Part I.A (describing how insurers historically could sometimes take advantage of the fact that insureds were only permitted to recover up to the amount of their policy).

82. *See supra* notes 25–28 and accompanying text (explaining that the initial reasoning behind allowing third-party claims was that the insured should not suffer as a result of the insurer's unreasonable actions).

83. *See supra* notes 34–38 and accompanying text (discussing Gruenberg v. Aetna Ins. Co., 510 P.2d 1032 (Cal. 1973), which involved an insurer that encouraged criminal charges against the insured in order to deny liability).

84. *See* Leland C. Smith, II, *Tort Liability for an Insurer's Bad Faith Refusal to Settle: A Developing Trend Appropriate for Adoption in Missouri*, 45 MO. L. REV. 103, 106–08 (1980) (discussing the development of bad-faith tort action in California to prevent an insurer from blatantly disregarding the best interest of the insured).

insurer; sentiments with which other courts could empathize and quickly justify an entirely new addition to their common law.[85]

A majority of jurisdictions now agree that bad faith requires an element of intent or reckless disregard;[86] however, this must be clarified. These courts have largely aligned with the Wisconsin Supreme Court's seminal decision in *Anderson v. Continental Insurance Co.*,[87] which established a more measured approach that considers the interests of both claimants and insurers.[88] Other courts, like the Supreme Court of California, have disagreed with this view, holding that mere negligence satisfies bad faith.[89] In states like Mississippi and New Mexico, the bad-faith standard is gross negligence.[90] Until significant legislative reforms in 2005, the West Virginia Supreme Court of Appeals had taken the most maverick approach, finding it "of little importance whether an insurer contests an insured's claim in good or bad faith," and holding that insurers could

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85. *See* Capozzola, *supra* note 25, at 188 (explaining that the most common argument for the availability of a bad-faith tort action is based on the fear that an insurer would otherwise act with impunity and deny claims when it benefits from doing so).

86. *See* James A. McGuire & Kristin Dodge McMahon, *Issues for Excess Insurer Counsel in Bad Faith and Excess Liability Cases*, 62 DEF. COUNS. J. 337, 339 (1995) (stating that a majority of jurisdictions require more than negligence, but less than the standard for fraud, to maintain a bad-faith cause of action).

87. 271 N.W.2d 368 (Wis. 1978).

88. *See id.* at 378 (holding that a plaintiff may recover for emotional distress caused by an insurer's bad faith refusal to pay a claim when the emotional distress is severe and the plaintiff has also suffered other substantial damages); Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions After Two Decades*, 37 ARIZ. L. REV. 1153, 1158–59 (1995) (noting that in 1995 at least ten of thirty jurisdictions followed the Wisconsin test, while others have taken the test a step further by requiring "gross negligence"); *see also* Capozzola, *supra* note 25, at 203–05 (proposing a bifurcated standard of negligence for actual damages, and an intentional or reckless disregard standard for punitive damages); McGuire & McMahon, *supra* note 86, at 339 (discussing how the Michigan judiciary identified factors—e.g., failing to inform the insured of developments, rejecting a reasonable offer of settlement, and disregarding legal advice—to aid in determining whether an insurer has acted in bad faith).

89. *See* Crisci v. Sec. Ins. Co. of New Haven, Conn., 426 P.2d 173, 173 (Cal. 1967) (discussing the tort of bad-faith in the context of tort claims generally, and explaining that damages are appropriate when a plaintiff is injured as a result of a defendant's negligent conduct). *But see* Shade Foods, Inc. v. Innovative Prod. Sales & Mrkt., 93 Cal. Rptr. 2d 364, 387 (Cal. Ct. App. 2000) (signaling a possible trend of courts moving away from the mere negligence standard by requiring that bad faith "rise to the level of unfair dealing").

90. *See* Aetna Cas. & Sur. Co. v. Day, 487 So. 2d 830, 832 (Miss. 1986) (holding that in order for an insured to receive damages above the amount of the policy, he or she must prove gross negligence on the part of the insurer); Jessen v. Nat'l Excess Ins. Co., 776 P.2d 1244, 1247 (N.M. 1989) (stating that based on a theory of either contract or tort, punitive damages are justified when an insurer acts with gross negligence); *see also* Henderson, *supra* note 88, at 1158 n.44 (explaining that gross negligence is a somewhat ambiguous term, but is generally considered more outrageous than ordinary negligence).

be held liable for consequential damages even for *reasonable* claim denials.[91]

By recognizing bad faith in the absence of an intentional act by the insurer, courts risk severely undermining the substance of this law. They expand the scope and boundaries of bad faith to encompass well-intentioned actions by insurers and they muddy the law's goal of giving notice of the type of conduct that will result in liability.[92] If bad faith comes to mean everything, then it will soon mean nothing. Therefore, to give any substantive meaning to a cause of action for bad faith, and to separate it from ordinary actions based in negligence, an element of intent must be present.[93] The concept of "negligence" can work well in measuring conduct that may threaten a physical harm such as negligent driving; however, it does not work well as a measure of conduct when an insurer, acting on a contract, makes a good-faith decision not to settle a case.

Courts such as the Arkansas Supreme Court have given meaningful substance to bad faith, reasoning that an insurer must have acted in a "dishonest, malicious, or oppressive" manner in delaying or denying an insured's claim.[94] In an attempt to maintain the integrity of bad-faith actions, the Supreme Court of Alabama imposed a "directed verdict" rule that requires the policyholder to be entitled to a directed verdict on its coverage claim in order for the insurance

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91. Hayseeds, Inc. v. State Farm Fire & Cas., 352 S.E.2d 73, 79 (W. Va. 1986). West Virginia's reform legislation, in part, abolished third-party insurance bad-faith claims, which is estimated to have saved the state's residents over $80 million since its enactment. *See* S.B. 418, 2005 Leg. (W. Va. 2005) (codified at W. VA. CODE ANN. § 33-11-4a (LexisNexis 2008)) (noting the bill's aim is to establish prerequisites to filing third-party bad-faith claims); *see also* Jake Stump, *Officials Say Ban on Bad Faith Suits Benefits Consumers*, CHARLESTON DAILY MAIL, Feb. 7, 2008, at 2A (noting the new system in place requires third parties to handle claims through the State Commissioner). In addition to eliminating third-party claims, the 2005 amendments to the state's bad-faith laws imposed an intentional tort standard for certain penalties issued by the state insurance regulators. *See* W. VA. CODE ANN. §§ 33-11-4a, 33-11-6 (LexisNexis 2006) (omitting a requirement that the insurer's action must rise to a general business practice if the insurer intentionally acts in bad faith).

92. *See supra* notes 79–80 (discussing how the current law's ambiguity makes the law easy to mold and, therefore, difficult to predict); *see also* BMW of N. Am. v. Gore, 517 U.S. 559, 574 (1996) ("Elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose.").

93. *See* Chavers v. Nat'l Sec. Fire & Cas. Co., 405 So. 2d 1, 6 (Ala. 1981) (reasoning that the policy considerations that preclude a negligence standard are not applicable when the cause of action arises out of intentional misconduct by the insurer).

94. Aetna Cas. & Sur. Co. v. Broadway Arms Corp., 664 S.W.2d 463, 465 (Ark. 1984); *see also* Christian v. Am. Home Assurance Co., 577 P.2d 899, 905 (Okla. 1977) (stating that tort liability is only appropriate where it is clear that the insurer acted unreasonably in avoiding liability under the insured's claim).

company's denial of coverage to constitute bad faith as a matter of law.[95] As a result, the law of bad faith in these states has proven to be consistent and predictable,[96] and has provided proper notice to insurers about what conduct will subject them to liability.

The same rationale applies equally to bad-faith statutes. Historically, these statutes present a mix of intentional and unreasonable acts brought under the umbrella of bad faith.[97] However, where private enforcement is authorized under these statutes, there exists the need for an intentional or reckless act, not a human error or simple miscommunication, as a basis to justify damages beyond the insurance contract. Some states, such as Minnesota, have recently codified an intentional tort standard for bad faith through amendments to bad-faith laws.[98] This is counterbalanced by other states' recent changes to bad-faith statutes, such as those in Colorado and Washington, which lower the bar to a simple negligence standard.[99]

By lowering the conduct standard for bad faith, states implicitly encourage less meritorious claims and permit the allegation of bad faith as standard practice in almost any insurance dispute. Actions such as clerical errors or even a computer malfunction or virus could result in substantial extra-contractual damages where there is no

95. *See* Nat'l Sav. Life Ins. Co. v. Dutton, 419 So. 2d 1357, 1362 (Ala. 1982) (noting that although the burden on the plaintiff is high, if an issue of material fact exists, the bad-faith tort claim must fail); *see also* Pickett v. Lloyd's, 621 A.2d 445, 453–54 (N.J. 1993) (allowing bad-faith tort claims only when a valid justification for the insurer's denial could not possibly exist). *But see* Skaling v. Aetna Ins. Co., 799 A.2d 997, 1005 (R.I. 2002) ("It makes little sense that an insurance company may . . . be insulated from tort liability for its bad-faith conduct because it fortuitously survives a motion for judgment as a matter of law, yet is ultimately found to have breached the insurance contract."); Marc S. Mayerson, *"First Party" Insurance Bad Faith Claims: Mooring Procedure to Substance*, 38 TORT TRIAL & INS. PRAC. L.J. 861, 870–71 (2003) (criticizing as illogical the basis of the rule because if an insurer had a reasonable justification for denying the claim, it could not have acted in bad faith).

96. There are less than a hundred reported appellate decisions involving bad-faith insurance claims settlement practices in Alabama and Arkansas in the past ten years.

97. *See supra* notes 51–61 and accompanying text (discussing the differences among states in the core elements of bad-faith statutes).

98. *See* S.F. 2822, 2008 Leg., 85th Sess. (Minn. 2008) (codified at MINN. STAT. ANN. § 604.18 (West 2000)) (allowing a court to award "taxable costs" if an insured proves that an insurer denied a claim with a knowing or reckless disregard and without a reasonable basis).

99. *See* H.B. 1407, 2008 Leg., 66th Sess. (Colo. 2008) (codified at COLO. REV. STAT. § 10-3-1115 (2008)) (implementing a reasonableness standard); S.B. 5726, 2007 Leg., 60th Sess. (Wash. 2007) (codified at WASH. REV. CODE § 48.30.015 (Supp. 2009)) (noting that the insured may apply other claims against the insurer based on unfair or deceptive practices, which are not subject to the bill's limits).

evidence of misconduct.[100] As a basic public policy issue, this is unwise and more likely to deny justice. Again, the concept of extra-contractual damages represents a relatively new and significant departure in remedies; it follows that an award of such damages should be supported by something more than an act of carelessness or misjudgment.[101]

2. Litigation of bad-faith claims should not intrude upon or duplicate the role of state regulators

Under the present system in many states, bad-faith enforcement may occur both through private laws and government enforcement.[102] A claimant may bring a cause of action at common law or pursuant to a bad-faith claims settlement statute, and the state insurance department may initiate a separate action. As a result of this dual enforcement, the insurer may be liable twice for the same or similar conduct. While proponents of such regimes may argue that this merely provides additional incentive for insurers to stay above board in all of their dealings, the notion of double punishment for the same act runs contrary to fundamental fairness within the civil justice system.[103]

In effect, a single insurer action may trigger several avenues for damages. An insurer may be forced to pay full contract damages (i.e., the policy limit), extra-contractual damages, which may also include punitive damages (which may itself be a multiplier of the total compensatory award), and stiff penalties from the state insurance department. As previously indicated, punitive damage awards alone may be millions of dollars, and state penalties, which likewise serve a punitive function, can reach hundreds of thousands

100. *See* Employee Mut. Cas. Co. v. Tompkins, 490 So. 2d 897, 898, 909 (Miss. 1986) (affirming punitive damages in the amount of $400,000 arising out of a bad-faith claim against an insurance company, which denied a claim based on a claims adjustor's misunderstanding despite the fact that the insurance company, upon learning of its mistake, immediately offered the correct compensation).

101. Unintentional errors more appropriately fall within the oversight of state insurance regulators who may fine insurers that fail to correct repeated errors. *See infra* Part II.A.4 (analyzing situations where an insurance company was found to have acted reasonably, although it was in error, and arguing that in such circumstances compensatory, not punitive damages, are the proper remedy).

102. *See supra* notes 58–63 and accompanying text (discussing the inconsistencies among state statutes relating to bad-faith torts).

103. *Cf.* United States v. Halper, 490 U.S. 435, 448–49 (1989) (holding that civil penalties following a criminal conviction for the same act can violate the Double Jeopardy Clause); Dep't of Prof. & Occupational Reg. v. Abateco Serv., Inc., 534 S.E.2d 352, 357 (Va. Ct. App. 2000) (holding that multiple civil fines for the same act are unconstitutional under a "gross disproportionality" standard).

of dollars.[104] These damages are in addition to an insurer's internal cost of compliance, so as to avoid future bad-faith litigation, and in some states, payment of the claimant's attorneys' fees and court costs.[105] Taken together, the insurer may be dealt a heavy blow on multiple levels for a single improper act.

Consider a scenario where a court does not require that bad faith include an element of intent. An insurer disputes a claim, reasonably from its perspective, but due to a clerical error in data-entry, fails to meet a statute's window of time for providing the proper claims forms.[106] Although the insurer did not intend to act in bad faith, it is now in violation of a bad-faith statute and may be punished by being ordered to pay the reasonably disputed claim in full, subjected to extra-contractual damages, fined thousands of dollars by the state, and forced to reengineer its claims processing system. Imagine further that this is an average-to-large-sized insurer with $2 billion in net premiums earned and a staff of hundreds who handle approximately 540,000 claims a year, or roughly 1,500 claims per day.[107] Even with a well-trained staff, human errors such as the one in this hypothetical cannot be completely eliminated when such large numbers are involved. Dual-enforcement by private and public actors makes this practically unavoidable scenario unjustifiable because it permits what amounts to multiple forms of punishment for the same act.[108]

A balanced solution requires a more defined structure of enforcement. Unintentional acts, which are nevertheless deemed unreasonable and inappropriately characterized as bad faith, should

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104. *See, e.g.*, R.I. GEN. LAWS § 27-29-6 (2005) (establishing a damages range of $5,000 to $25,000 for each insurer violation up to $250,000); *see also supra* note 9 and accompanying text (highlighting several cases in which punitive damages amounted to tens of millions of dollars).

105. *See supra* notes 24, 64 (examining a variety of damages, created by state statutes, that may be awarded for an insurer's bad-faith acts).

106. *See* statutes cited *infra* notes 181–84 and accompanying text (listing statutory time limits for filing a claim).

107. *See generally* BEST'S AGGREGATES & AVERAGES: PROPERTY CASUALTY U.S. & CANADA (2008). According to an analysis of A.M. Best data, an insurer with $2 billion in premium dollars (net premiums earned) handled an estimated annual average of approximately 540,000 claims from 2001–2007, or roughly 1,500 claims per day. These figures are based on data showing net premiums earned and claims reported across eight major lines of property casualty insurance. Annual premiums of $2 billion rank an insurer roughly 40th countrywide in highest total premiums and represent the average premium total of the top 250 insurers countrywide, which have ninety-five percent of U.S. market share.

108. In this example, paying full contract damages on a reasonably disputed claim which the insurer would have otherwise prevailed upon can be viewed as an additional form of punishment from the extra-contractual damages action and the state regulatory penalty.

fall within the sole jurisdiction of state regulatory authority. After all, state insurance departments are charged with regulating insurance practices, and they develop comprehensive regulations to that end. They are in the best position to impose a commensurate fine to discourage on a state-wide basis acts that amount to simple error, without disrupting or skewing the true merits of the underlying insurance claim.[109] Further, the claimant may individually recover damages caused by the delay under traditional contract theory.[110]

By way of contrast, where the insurer engages in a purposeful and malicious act to deny coverage under a particular claim, the less exacting instrument of private tort litigation enables harsher punishment. Courts should, therefore, refrain from permitting private bad-faith actions that may unfairly yield multiple recoveries where the basis of the action encroaches upon the very purpose and function of state regulatory authority.

3. Courts should not imply a private right of action or use a claims settlement statute as a common law proxy unless expressly authorized by the state legislature

While courts endeavor to iron out many differences within the law of bad faith and attain some semblance of uniformity among states, they should not, as a basic constitutional law principle, imply private rights of action for violations of insurance claims statutes.[111] As a corollary, courts should also reject the use of claims settlement statutes as a proxy for what constitutes bad faith in a common law action because of the law's inconsistent treatment and because of the historical context in which legislatures drafted these statutes.

During the 1970s, as states began to embrace the common law expansion of a tort action for bad faith and legislatures quickly moved to enumerate bad-faith conduct,[112] the specifics of the law

109. *See* Lawton v. Great S.W. Fire Ins. Co., 392 A.2d. 576, 581 (N.H. 1978) (explaining the various benefits of the state insurance department bad-faith guidelines, including for instance, a policy that allows every fire insurance claimant the right to an independent appraiser of a claim, thereby preventing bad-faith action on the part of the insurer before the claim may be denied or delayed).

110. *See id.* (finding that contract remedies eliminate the need for a private cause of action).

111. *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761, 765 (2008) (arguing that the doctrine of separation of powers requires that courts only imply a cause of action "if the underlying statute can be interpreted to disclose the intent to create one"); *cf.* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 190–91 (1994) (discussing the "far-reaching consequences" of implying a cause of action under the Securities and Exchange Act).

112. *See supra* Part I (examining the motivations behind early bad-faith statutes and jurisprudence).

remained unsettled. Courts generally recognized the importance of leveling the playing field in certain transactions, such as insurance, but concentrated their decisions on justifying the adoption of this new addition to the common law, a weighty proposition for any court, rather than analyzing its nuances.[113] It is in this context that states enacted bad-faith statutes, incorporating the model NAIC legislation.[114] These laws attempted to identify bad faith before the case law had adequately developed and defined "bad faith" (other than to acknowledge its existence). The statutes were also often silent as to who had standing to sue.[115] Indeed, many states at the time were still determining whether the common law action applied to first-party claimants, third-party claimants, or both.[116] As case law developed and courts began tackling these issues, the results varied widely across states.[117]

The expediency in which states, anxious to combat the bad acts of insurers, adopted wholesale NAIC's model legislation, while presumably well-intentioned, has been a cause of the inconsistencies faced by both insurers and claimants today. These laws not only diluted the substance of bad faith by reducing culpability to a negligence standard—an action that was subsequently rejected in the common law of a majority of states—but also exacerbated inconsistencies in standing by failing to clearly address enforcement of the statute.[118] Moreover, because these statutes amount to a premature exploration of the law of bad faith, they should be treated as such by courts, which can and should minimize the impact of the statutes while still enforcing the law. Courts should not, therefore,

113. *See supra* Part I.B (arguing that the many discrepancies in interpretations of state laws addressing bad-faith tort claims may be attributed to the court's failure to take into account the nuances of the statutes).

114. *See supra* notes 48–50 (discussing the adoption of the NAIC Model Act in 1972 and listing the many states that adopted this Act nearly wholesale).

115. *See supra* notes 58–61 and accompanying text (discussing the courts' struggle to determine whether or not to allow first-party and third-party suits in insurance bad-faith tort claims).

116. *See supra* note 43 (discussing the expansion of standing in bad-faith tort claims during the 1970s and 1980s).

117. *See supra* Part II.B (arguing that one major point of diversion among states is the level of culpability required before punitive damages are awarded to the insured, and criticizing those states that allow punitive damages to be awarded in cases of mere negligence on the part of the insurer).

118. *See* Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58, 67–68 (Cal. 1988) (discussing the questions left unanswered by California's introduction of a private action for bad-faith claims against insurers, including failing to explain what may be considered a "bad faith" action, who has standing, and the amount of damages available).

imply a private right of action under an unfair claims settlement statute unless the legislature has expressly stated its intent to do so.[119]

The use of a claims settlement statute as a proxy for a common law action for bad faith represents an issue of greater practical significance. It is an established practice for courts to look to a closely related statute when determining the scope or applicability of the common law.[120] Former Harvard Law School Dean James Landis, almost eighty years ago, articulated this "gravitational pull" effect in which a legislature's statutory policy guides the development of the common law.[121] Courts today often use insurance claims settlement statutes in this capacity.[122] While this exercise may prove valid and insightful to courts in some instances, the law of bad faith presents the rare set of circumstances where this practice is inappropriate because the common law reflects a more contemporary view than the statutes reflect. The common law of a majority of states has since rejected liability for the unintentional acts committed by insurers, contrary to the provisions of virtually all of the states' unfair insurance claims settlement acts. The courts' use of such antiquated laws as a proxy to guide the common law, therefore, ignores and undermines the development of the law of bad faith.

4. Where an insurer's wrongful act is the result of a mistake or unintentional error, a right to cure without penalty should be permitted

A key step in restoring a sense of balance to the law of bad faith is to curb the flow of bad-faith claims that have improperly fueled

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119. *See infra* Part III.B.1 (arguing that such a policy promotes fairness and has constitutional value).

120. *See* DeMaria v. DeMaria, 724 A.2d 1088, 1091 (Conn. 1999) (noting that "statutes are a useful source of policy for common-law adjudication, particularly when there is a close relationship between the statutory and common-law subject matters"); *see also* GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 1 (1982) (arguing that the United States legal system has shifted from being dominated by common law to being dominated by statutes); Ellen Ash Peters, *Common Law Judging in a Statutory World: An Address*, 43 U. PITT. L. REV. 995, 998 (1982) (arguing that the role of statutes in the development of common law has evolved from being narrowly construed to avoid "derogation of the common law" to playing a central role—being taken "into account virtually all of the time"). Courts now commonly use statutes to guide policy and provide "consistent common law development." *Id.*

121. *See* James McCauley Landis, *Statutes and the Sources of Law*, *in* HARVARD LEGAL ESSAYS 213–14, 233 (R. Pound ed., 1934) (arguing that much of the common law actually originated in statutory legislation, and concluding that the "cavalier treatment of legislation" at the time was "certain to be a passing phenomenon"); *see also* Frank M. Coffin, *Review: The Problem of Obsolete Statutes: A New Role for Courts?*, 91 YALE L.J. 827, 832 (1982) (discussing the connection between Guido Calabresi's scholarly works on statutes and common law and those of James Landis).

122. *See supra* note 63 and accompanying text (describing how courts inferred private rights of action from statutes that may not explicitly grant them).

national litigation by focusing on minor technical infractions. These claims may nevertheless trigger a state's bad-faith claims settlement statute or be used as a proxy in a common law action. For the most part, such claims involve instances where an insurer missed strict deadlines for "reasonable" claims-processing,[123] where an insurer unintentionally failed to communicate certain information to the insured or another party,[124] or where an insurer's employee committed other human errors.[125] These claims are often brought by enterprising plaintiffs' attorneys who seek out violations in hope of reaching a quick or greater settlement than may otherwise be warranted.[126] Where such claims appear, and where it is clear that they are the result of a simple mistake, misunderstanding, or human error that the insurer is readily willing to correct, courts should recognize a "right to cure" and preclude a bad-faith lawsuit to recover extra-contractual damages. Such an approach would properly focus the law on the tort law goal of promoting good behavior. It would also not violate the tort law goal of promoting just compensation, because the corrective action by the insurer abates economic loss which may have been endured by the claimant.

As stated throughout this Article, the central concept underlying the law of bad faith is to discourage bad acts which should equate, and do in most jurisdictions, to purposeful or reckless acts. The remedy of damages beyond the contract serves an essentially punitive and deterrent function against future bad acts.[127] Mistakes and human error, and the insurers' willingness to correct those mistakes, comport with neither justification. Mistakes take place

123. *See, e.g.*, Porcelli v. OneBeacon Ins. Co., Inc., No. 2:07-cv-613-FtM-29DNF, 2008 WL 2776725, at *5–6 (M.D. Fla. July 15, 2008) (allowing a bad-faith action to proceed where the insurer did not meet the statute's thirty-day deadline to provide policy information); *see also infra* Part II.B.2 (discussing reasonableness standards).

124. *See, e.g.*, Kissoondath v. United States Fire Ins. Co., 620 N.W.2d 909, 916 (Minn. Ct. App. 1983) (citing Short v. Dairyland Ins. Co., 334 N.W.2d 384 (Minn. 1983)) (proposing that evidence of a failure to communicate a settlement offer to the insured supports a finding of bad faith by the insurer); Romano v. Nationwide Mut. Fire Ins. Co., 646 A.2d 1228, 1232 (Pa. Super. Ct. 1994) (stating that bad-faith conduct includes failure to communicate with a claimant).

125. *See, e.g.*, Town & Country Mut. Ins. Co. v. Hunter, 472 N.E.2d 1265, 1269 (Ind. Ct. App. 1985) (finding that the insurer's statement of coverage and the discovery of the insured's death two weeks after the accident were "attributable to mere human error" and reversing the trial court's punitive damages award).

126. *See supra* note 6 (noting that attorneys handling claims against insurance companies seem to be more interested in finding evidence of bad faith than actually collecting on the claims).

127. *See* O'Neill v. Gallant Ins. Co., 769 N.E.2d 100, 111 (Ill. App. Ct. 2002) (reasoning that "punitive damages can provide some degree of deterrent against unscrupulous insurers who would otherwise take advantage of customers and abuse their fiduciary relationship in order to promote their own economic self-interest").

regardless of whether a remedy is limited to the contract or some measure of extra-contractual recovery.[128] Furthermore, the remedy for such human error is already provided for in every state through regulatory enforcement and contract law.[129] State insurance regulators are empowered to fine insurers for each and every mistake that results in a technical violation of the law, and where human errors are repeated to a level exceeding societal tolerances.[130] Regulatory authorities can also require improved practices for insurers and levy additional harsh penalties for noncompliance.[131] These penalties apply regardless of private enforcement. If any economic losses remain after the insurer has taken action to correct its mistake, contract damages can provide for the direct economic losses incurred. A bad-faith lawsuit seeking additional recovery for mistakes and unintended errors only serves as a windfall to plaintiffs and their attorneys.

Permitting tort recovery for minor technical errors, in addition to lacking a rational justification, has other negative consequences. First, a successful private lawsuit has the practical effect of taking the place of state insurance regulation because it alters the insurers' actions, but such de facto regulation is not subject to the public accountability of regulation by a state agency. Second, allowing a private action in these instances may encourage an insurer's bad faith by unjustly altering the litigation dynamic. If an insurer commits an unintended error and is confronted with a bad-faith lawsuit, including the potential for punitive or exemplary damages, the insurer may be compelled to inappropriately challenge the claim that it made a mistake.[132] Further, if a claimant's settlement offer is unreasonably high, perhaps due to the superior bargaining position the claimant finds himself or herself in where a mistake has occurred,

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128. *See* Victor Schwartz & Christopher Appel, *Effective Communication of Warnings in the Workplace: Avoiding Injuries in Working with Industrial Materials*, 73 MO. L. REV. 1, 14–15 (2008) (discussing the cognitive limits of employees in the workplace).

129. *See supra* Part II.A.2 (discussing the roles and distinctions between regulators and litigators); *see also* Choharis v. State Farm Fire & Cas. Co., 961 A.2d 1080, 1088–90 (D.C. 2008) (rejecting tort liability against insurers and identifying other available remedies for insureds).

130. Statutes often refer to such repeated errors as acts committed "with such frequency as to indicate a general business practice." *See, e.g.*, ARIZ. REV. STAT. ANN. § 20-461 (2008); MD. CODE ANN. INS. § 27-304 (2008); N.J. STAT. ANN. § 17B:30-13.1 (2009).

131. *See, e.g.*, Henderson, *supra* note 19, at 12 n.39 (listing various state statutes enacted at the turn of the century that allowed for recovery of attorneys' fees and penalties).

132. Settlement typically provides a reasonable alternative, but if a plaintiff is unwilling to settle in hopes that a jury will award exemplary damages, litigation becomes the only recourse for the insurer.

the insurer may be compelled to litigate a claim based on a mistake in the hopes of paying only nominal damages. In either event, dishonesty and cover-up are encouraged, which in addition to subverting justice, reduces efficiency and circumvents a state's regulatory authority.[133]

A right to cure a mistake or human error alleviates these system strains while providing greater efficiency and fairness. If permitted to remedy the error without incurring additional penalties, insurers might be more likely to admit their mistakes, many of which might otherwise go undiscovered. Hence, a right to cure could improve transparency and honesty in insurance claims-handling.

A statutory right to cure is currently available in a minority of states. Florida, for example, permits a right to cure "if, within 60 days after filing notice, the damages are paid or the circumstances giving rise to the violation are corrected."[134] Similarly, West Virginia allows insurers a right to cure within 60 days of receiving notice of an action from the state's insurance commissioner.[135]

This notion of a right to cure also exists in many other legal incarnations such as sellers' rights under the Uniform Commercial Code,[136] a homeowner's right of redemption,[137] and various other consumer transactions.[138] Similar to a buyer receiving a non-conforming product under a sales contract and the seller being able to redress the issue, the insurer should be able to rectify an unsatisfactory handling of claims under an insurance contract. The principle of encouraging "cure" is common in other areas of law as well. For example, rules of evidence preclude the admission of subsequent remedial measures to improve the safety of a product or service when it is offered as proof of an admission of fault.[139]

By allowing a right to cure and by precluding a bad-faith lawsuit where the insurer makes a clear effort to correct its mistake, courts

133. *See supra* Part II.A.2 (discussing how private bad-faith actions may unnecessarily mirror state regulatory actions).

134. FLA. STAT. ANN. § 624.155(3)(d) (2009); *see also* Talat Enter., Inc. v. Aetna Cas. & Sur. Co., 753 So. 2d 1278, 1284 (Fla. 2000) (recognizing the legislature's intent to provide insurers a sixty-day window as a final resort to comply with their contractual obligations).

135. W. VA. CODE ANN. § 33-11-4a(b)(4) (LexisNexis 2008).

136. U.C.C. § 2-508 (2003).

137. *E.g.*, COLO. REV. STAT. § 38-38-302 (2009); KAN. STAT. ANN. § 60-2414 (2008); TEX. PROP. CODE ANN. § 209.011 (2007).

138. *See, e.g.*, IOWA CODE § 537.5110 (2009) (consumer right to cure credit debts); R.I. GEN. LAWS § 6-51-3 (2008) (right to cure automobile payment deficiency prior to repossession); *see also* 11 U.S.C. § 1322 (2006) (plan to cure defaults during bankruptcy).

139. FED. R. EVID. 407.

and legislatures could greatly improve the landscape of bad-faith claims; they could improve the efficiency and transparency of claims-handling and promote fairness to both sides of insurance transactions.

5. Courts should recognize a limited action for reverse bad faith against insurers

Until now, bad-faith law has been almost exclusively a one-way street.[140] Claimants may maintain a tort cause of action under statute or common law against the insurer for a breach of the implied covenant of good faith and fair dealing, but insurers in those same jurisdictions are extended no reciprocal right of action for claimants' wrongful acts.[141] The justifications for this facial inequity are not entirely clear or persuasive other than that there is virtually no case law to support a "reverse bad-faith" claim.[142] Yet, as one may recall, this situation is strikingly reminiscent of the landscape of bad-faith law only decades ago.[143] At the time, it was clear one side had an

140. *See* Commercial Union Assurance Cos. v. Safeway Stores, Inc., 610 P.2d 1038, 1041 (Cal. 1980) (stating 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," but holding that no reciprocal right applies); Douglas R. Richmond, *The Two-way Street of Insurance Good Faith: Under Construction, But Not Yet Open*, 28 LOY. U. CHI. L.J. 95, 140 (1996) (arguing in favor of a reverse bad-faith right of action).

141. *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, 528–31 (1994) (observing court decisions that have rejected reverse bad-faith claims); John F. Dobbyn, *Is Good Faith in Insurance Contracts a Two-Way Street?*, 62 N.D. L. REV. 355, 357–67 (1986) (examining a brief history of bad-faith claims); Cathryn M. Little, *Fighting Fire with Fire: "Reverse Bad Faith" in First-Party Litigation Involving Arson and Insurance Fraud*, 19 CAMPBELL L. REV. 43, 44-46 (1996) (noting that there are few published opinions citing "reverse bad faith," none of which recognize the claim as a cause of action); Douglas R. Richmond, *Insured's Bad Faith as Shield or Sword: Litigation Relief for Insurers?*, 77 MARQ. L. REV. 41, 69 (arguing in favor of a bad-faith cause of action for insurers); 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 TRIAL & INS. PRAC. L.J. 215, 216 n.7 (1987) (recognizing California as the only state that has adopted a reverse bad-faith rule).

142. Several courts have attested to the lack of case law supporting a reverse bad-faith claim. *See, e.g.*, General Accident Ins. Co. of America v. Shah, No. 6:00-cv-489-ORL28KRS, 2001 WL 273244, at *3 (M.D. Fla. Jan. 23, 2001) (adhering to the common law when a bad-faith claim was not yet ripe for consideration); *In re* Tutu Water Wells Contamination Litig., 78 F. Supp. 2d 436, 455 (D. V.I. 1999) (denying insurers' reverse bad-faith claim on summary judgment); Johnson v. Farm Bureau Mut. Ins. Co., 533 N.W.2d 203, 208 (Iowa 1995) (claiming to be unaware of any jurisdiction adopting the tort of reverse bad-faith claims); *see also* Willia Corroon Corp. v. Home Ins. Co., 203 F.3d 449, 453 (7th Cir. 2000) (expressing serious doubts about whether a reverse bad-faith action exists without completely foreclosing the recognition of such an action); *cf.* Parker v. D'Avolio, 664 N.E.2d 858, 864 n.9 (Mass. Ct. App. 1996) (cautioning in a landlord tenant case that "courts be vigilant to ensure that plaintiffs not engage in 'reverse bad faith' conduct").

143. *See supra* Part I.A (discussing the history and development of bad faith).

advantage in insurance transactions and at least an arguable ability to engage in abusive acts without sufficient deterrence. It took one high court's ruling to set in motion changes on a national scale and restore, albeit temporarily, a sense of balance in insurance claims-handling.[144]

If the history of bad-faith law is to repeat itself by recognizing a reciprocal action for insurers against their insureds, it might well have received its first signs of life from a court in its birthplace of California. In *California Casualty General Insurance Co. v. Superior Court*,[145] the California Court of Appeal held that an insurer in a bad-faith action could assert as an affirmative defense the tort concept of comparative fault.[146] The plaintiff in the case brought a bad-faith claim against his insurer alleging unreasonable delay in providing coverage under an uninsured motorist claim, which the insurer believed to be a questionable and potentially frivolous claim.[147] The insurer claimed comparative bad faith on the plaintiff's part and sought attorneys' fees.[148] The court agreed with the insurer and held that comparative bad faith provided a valid defense.[149] The court also appeared to be acutely aware of the implications of its decision, stating that "most defenses now recognized in tort cases were at one time novel and not expressly recognized in published judicial decisions."[150]

For fifteen years, this decision stood in California.[151] In *Kransco v. American Empire Surplus Lines Insurance Co.*,[152] however, the state high court retreated from these reverse bad-faith footholds and invalidated the defense.[153] The majority reasoned that the comparative bad-faith defense "misleadingly equates an insured's contractual breach of the reciprocal covenant of good faith and fair dealing with an insurer's

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144. *See supra* Part I.A (discussing the role of the California Supreme Court in engineering tort recovery for bad faith).
145. 218 Cal. Rptr. 817 (Cal. Ct. App. 1985).
146. *See id.* at 822 (additionally noting that the insured owed an implied duty of good faith and fair dealing to the insurer).
147. *Id.* at 818–19.
148. *Id.*
149. *Id.* at 823 (explaining that while the duty of good faith is a contractual term, breach of this duty is governed by tort principles).
150. *Id.* at 821.
151. The Chief Justice of California characterized *California Casualty* as "the seminal California decision that has been the controlling California authority on this issue for the past 15 years." Kransco v. Am. Empire Surplus Lines Ins. Co., 2 P.3d 1, 17 (Cal. 2000) (George, J., concurring in part and dissenting in part).
152. 2 P.3d 1 (Cal. 2000).
153. *Id.* at 4. The court in *Kransco* relied on a 1999 California Court of Appeal decision that rejected a reverse bad-faith claim. *See* Agric. Ins. Co. v. Superior Court of Los Angeles County, 82 Cal. Rptr. 2d 594, 600–02 (Cal. Ct. App. 1999) (finding that the reverse bad-faith claim had no support in case law).

tortious breach of the covenant,"[154] and that an insurer's tort liability for breach of the covenant is "predicated upon special policy factors inapplicable to the insured."[155] Although the court did not detail these policy factors in its decision, they were discussed in a California Court of Appeal opinion issued a year earlier in *Agricultural Insurance Co. v. Superior Court*,[156] which similarly rejected an insurer's reverse bad-faith claim. That court summarized the special policy factors as follows:

> An insured seeks peace of mind and economic protection against calamity, the insurer provides that protection for a fee. Although the insured depends upon the insurer for protection, the insurer does not depend on the insured in the same manner. Insurers occupy the "status as purveyors of a vital service labeled quasi-public in nature." Thus an insurer's obligations can include a duty to place the interests of the insured on at least an equal footing with its own interests, because the "obligations of good faith and fair dealing encompass qualities of decency and humanity" similar to the responsibilities of a fiduciary. Insurance contracts are usually adhesive in nature, since their terms are generally contained in form language dictated by the insurer . . . . An insurer's breach can therefore frustrate the core purpose of insurance (protecting the insured from calamity) and leave the insured exposed to a disaster it has paid to avoid.[157]

These policy justifications are echoed by high courts in other states, such as Ohio and Iowa, which have also directly addressed and rejected an insurer action for reverse bad faith.[158]

As sound public policy, such justifications appear somewhat suspect. They are premised on the idea that despite entering the same contract, with the same implication of good faith and fair dealing, the actual obligations should be different because performance of the contract "matters more" to the insured. While it may be true that an insurer, generally speaking, has more resources to insulate itself from financial hardship, this does not mean that the total financial loss experienced from an act of bad faith is any less when it happens to an insurer. Insurance fraud is estimated to cost

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154. *Kransco*, 2 P.3d at 12.
155. *Id.* at 11.
156. 82 Cal. Rptr. 2d 594 (Cal. Ct. App. 1999).
157. *Id.* at 600 (citations omitted); *see also* Foley v. Interactive Data Corp., 765 P.2d 373, 374 (Cal. 1988) (rejecting the application of the insurance law theory of tortious breach of covenant in an employment law action).
158. *See* Johnson v. Farm Bureau Mut. Ins. Co., 533 N.W.2d 203, 208 (Iowa 1995) (finding that a motion for sanctions under local rule 80(a) provides sufficient remedy); Tokles & Son, Inc. v. Midwestern Indem. Co., 605 N.E.2d 936, 945 (Ohio 1992) (noting that insurers have other means of protection).

the industry approximately $80 billion per year.[159] Nevertheless, that the insurer is virtually always the wealthier party in the litigation appears to be the underlying justification for making a distinction in the law. Insurance may be "big business," but that has never provided a legitimate basis to apply unequal protection under the law. Further, in most situations, these costs are ultimately borne not by a "wealthy insurer," but by ordinary policyholders who end up paying more for insurance because of the wrongful acts of relatively few policyholders.[160]

The other special factors proffered—that an insured seeks peace of mind and that insurance contracts are adhesive—also do little to justify disparate treatment for insurers. First, parties to any contract seek peace of mind. It is a basic purpose of contracting. The buyer seeks peace of mind that the seller will perform as scheduled and the seller rests easier once it has found a buyer for its good or service. Second, the fact that insurance contracts are adhesive has nothing to do with the implied covenant of good faith. Contract provisions, adhesive or not, are express terms that apply to a specific agreement, while the implied covenant of good faith applies to every agreement.[161] Consequently, as a matter of policy, there is little rational justification for not allowing a reverse bad-faith claim where a private action has been recognized under common law.

Combining the other general principles discussed, a reverse bad-faith claim would likely be very limited in practice. It should only apply to intentional and purposeful acts by claimants to either receive a payment where payment is inappropriate, or to inflate a claim amount. From a public policy vantage, it would provide additional incentive for persons making a claim against an insurer to state the measure of damages more accurately and honestly, which in turn would reduce the costs of insurance for consumers. A reverse bad-faith action would also only be appropriate where the common law permits private enforcement against an insurer, thereby respecting constitutional law principles discussed previously against implying causes of action.

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159. *See* How Big is $80 Billion?, Coalition Against Insurance Fraud, http://www.insurancefraud.org/80_billion.htm (last visited July 27, 2009) (illustrating the extent of the loss that results from insurance fraud).

160. *See generally* Insurance Fraud, Federal Bureau of Investigation, http://www.fbi.gov/publications/fraud/insurance_fraud.htm (last visited July 27, 2009) (explaining that insurance fraud costs the average U.S. family between $400 and $700 per year in the form of increased premiums).

161. *See* Brassil v. Maryland Cas. Co., 104 N.E. 622, 624 (N.Y. 1914) (recognizing that the good-faith requirement underlies all contracts).

Moreover, a reverse bad-faith action would be less akin to creating a new cause of action than applying an existing action equally. Also, given the respective roles in an insurance relationship, the appropriate extra-contractual remedy for the insurer in most instances would be limited to attorneys' fees for the claimant's willful and malicious conduct.[162] Although courts have yet to embrace reverse bad-faith actions, such actions comport with objectives of fundamental fairness and equal protection, and greater system efficiency and effectiveness.[163] Also vital to these public policy objectives is the fact that an overwhelming number of "honest" policyholders would benefit from lower premiums if the acts of dishonest policyholders were properly sanctioned.

B. Principles Applicable to Bad-Faith Statutes

1. Courts need to clearly identify who may bring a statutory "bad-faith" action

Independent of the common law, state legislatures have enacted statutes to govern bad faith in insurance claims handling. As previously discussed, these laws were derived from model legislation and many incorporate the same or substantially similar provisions.[164] Also as discussed, many of these laws suffer shortcomings that have led courts to apply widely divergent interpretations and have caused inconsistency in the state of bad-faith law.[165] One of the most basic shortcomings is that many of these laws are ambiguous as to who may bring a statutory cause of action for bad faith.

162. In a related issue, a majority of courts permit an insurer to recover attorneys' fees where the insurer defends non-covered acts under the insurance agreement. *See* Joseph Cunningham & James Markels, *Attorneys' Fees Incurred In Defending Insurance Policy Non-Covered Claims: Who Pays?*, 2 BROOK. J. CORP. FIN. & COM. L. 69, 74–76 (2007) (reviewing majority and minority views across various jurisdictions); *see also* Gen. Agents Ins. Co. of Am. v. Midwest Sporting Goods Co., 828 N.E.2d 1092, 1098 (Ill. 2005) (considering whether a contract must stipulate the right to recover costs and attorneys' fees).

An insurer's decision to initially provide representation in a situation where such representation is not required is often made out of fear of subsequent bad-faith litigation in the event the insurer is mistaken. *See supra* note 9 and accompanying text (discussing rising costs and increasing damage awards in bad-faith suits).

163. *See* Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 136–37 (1994) (enumerating reasons why courts should apply reserve bad faith).

164. *See supra* Part I.B (discussing the various types of bad faith claims settlement statutes adopted from state to state).

165. *See supra* Part I.B.

Identification of a class of potential claimants is particularly important due to another alleged flaw in many states' laws: the varying degree of culpability necessary to establish bad faith.[166] A claimant who is unable to bring a common-law action for bad faith because the level of culpability requires an intentional or reckless act will instead attempt a statutory cause of action where lesser misconduct—e.g., negligence—may support a claim. Courts should identify the scope of such statutes not only to prevent this derogation of the common law, but also to establish clear boundaries to reduce uncertainty or unfair surprise for litigants.

Principles of statutory construction provide the starting point in determining the scope of ambiguous claims settlement laws, and the text, context, and history of these laws should carry the day.[167] Again, as a general principle, where a statute does not expressly create a private cause of action, courts should exercise a high level of restraint before implying one.[168] Similarly, where the text of a claims settlement statute expressly states that the insurance commissioner may bring an action or impose a fine (as most of the statutes do), but where the statute fails to mention a similar right for an individual claimant, courts should hold that the legislature did not intend a private right of action. Courts addressing this issue have almost uniformly agreed and precluded a right.[169]

Where a statute omits reference to public or private enforcement, the context and history of the law deserve deference. In every state, the claims settlement statute is included in a code section regulating the practice of insurance.[170] This body of law is enforced by the state insurance department and typically does not provide for private enforcement. In contrast, in states like Rhode Island and Pennsylvania where a private right of action for bad faith is expressly provided, the state legislature has included that right under a

166. *See supra* Part I.B.

167. *See* City of Rancho Palos Verdes, Cal. v. Abrams, 544 U.S. 113, 129 (2005) (Stevens, J., concurring) (noting that when the Court "perform[s] this gap-filling task, it is appropriate not only to study the text and structure of the statutory scheme, but also to examine its legislative history").

168. *See* cases cited *supra* note 111 (cautioning against an implied cause of action).

169. *See* cases cited *supra* notes 60–61 (discussing claims that were based on an implied cause of action). In 1990, NAIC approved a separate model act entitled the Model Unfair Claims Settlement Practices Act. UNFAIR CLAIMS SETTLEMENT PRACTICES ACT § 1, *reprinted in* NAT'L ASS'N OF INS. COMM'RS MODEL LAWS, REGULATIONS AND GUIDELINES 900–01 (1991). This Act, unlike the 1972 model legislation, contains a "Drafting Note" stating that any jurisdiction choosing to provide a private cause of action should consider a different statutory scheme, and that the Act "is inherently inconsistent with a private cause of action." *Id.*

170. *See supra* note 47 (listing the various state statutes that address bad-faith and unfair insurance claims).

separate section of law, such as the civil code,[171] or through a constitutional amendment.[172] The placement of these laws in state regulatory codes as opposed to sections relevant to individuals' rights suggests that the law is meant for public enforcement. Also, in other states expressly codifying a private right of action, like Montana[173] and Florida,[174] the private action is codified in separate statutes.

Historically, claims settlement statutes represented a push by state legislatures to compliment the common law, not to override it. The statutes were enacted during the same period in which states first expanded their common law to include bad faith; statutes and common law were thus at the same level of development. There was little need to expedite the law's passage if only to codify private enforcement of common law. Rather, it is more plausible that these laws were designed to provide a separate level of protection through state regulatory enforcement.

Overall, the construction of states' claims settlement statutes leads to the conclusion that enforcement should be deemed exclusive to a state's insurance department or commissioner. Courts not yet addressing the complete scope of unfair claims settlement laws should, therefore, refrain from expanding the action to first-party or third-party claimants. From an enforcement perspective, the regulatory and common law systems left in place are also more consistent.[175] The state regulates unreasonable insurer practices and takes enforcement action against violators through its insurance regulatory arm, and the common law is left to redress intentional and reckless acts above contractual or compensatory damages. The fact that the common law of bad faith continues to develop (in contrast to claims settlement statutes that are changed less often) also makes the common law ideally suited to addressing more culpable and varied insurer "bad" acts. By clearly identifying the scope of ambiguous unfair claims statutes as publicly enforceable by state insurance regulators, courts can establish a simpler, more efficient system of enforcement.

171. *See* R.I. GEN. LAWS § 9-1-33 (2008) (allowing an insured to bring a bad-faith action against the insurer).

172. *See* 42 PA. CONS. STAT. § 8371 (2008) (allowing courts to award interest, punitive damages, costs, and fees if they have found that the insurer acted in bad faith towards the insured).

173. MONT. CODE ANN. § 33-18-242 (2007).

174. FLA. STAT. ANN. § 624.155 (2009).

175. *See supra* Part II.A.2 (arguing that bad-faith claims should not both be privately litigated and should instead fall under the state's regulatory scheme).

2. *Overly mechanical application of deadlines for reasonable investigation and payment of claims should be avoided*

A central concept present in all claims settlement statutes is reasonableness.[176] If an insurer fails to process, investigate, or pay a claim within a "reasonable" period, then its delay may constitute an act of bad faith.[177] Generally, in a statutory action brought by the state insurance commissioner or, where permitted, a private claimant,[178] the determination of a reasonable period is made by a jury.[179] Given the wide spectrum of circumstances that could make delay more reasonable in one case than in another, and given the clear potential for over- and under-inclusiveness in attempting to provide greater definition to what is reasonable, the law appropriately leaves this decision in jurors' hands. A significant minority of states, however, supplant this jury function by legislating strict time periods for unreasonable delay in insurance claims-handling.[180]

For example, in states like Oklahoma, Rhode Island, and South Dakota, an insurer violates the state's unfair claims settlement act whenever it fails to respond to a claim within thirty days.[181] In Georgia, Missouri, and Nebraska, an insurer must provide to a claimant the necessary claims forms within fifteen days of a reasonable request.[182] Other states set the period of reasonableness at ten[183] or twenty days.[184]

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176. *See supra* note 47 (listing the various state statutes that address bad-faith and unfair insurance claims). In some states, like Alabama, the statute contains the terminology "without just cause," which approximates to a reasonableness test. ALA. CODE § 27-12-24 (2009).

177. *See, e.g.*, Filasky v. Preferred Risk Mut. Ins. Co., 734 P.2d 76 (Ariz. 1988); Transp. Ins. Co. v. Moriel, 879 S.W.2d 10 (Tex. 1994); Fehring v. Republic Ins. Co., 347 N.W.2d 595 (Wis. 1984); *see also* Henderson, *supra* note 88, at 1159–60 (enumerating acts of bad faith in addition to unreasonable delay or denial of claims).

178. A key distinction here is that the standard under most statutory actions brought by the state insurance commissioner is negligence, while only a minority of states permit private statutory enforcement under this reasonableness standard or under the state's common law standard. *See supra* Part I (discussing the history and development of bad faith and bad-faith statutes).

179. *See supra* note 79 (recognizing the flexibility given to juries in determining what constitutes bad faith).

180. Such states include Connecticut, Florida, Georgia, Hawaii, Illinois, Iowa, Maine, Michigan, Mississippi, Missouri, Nebraska, Nevada, New Mexico, Oklahoma, Rhode Island, South Dakota, Washington, West Virginia, and Wisconsin.

181. OKLA. STAT. tit. 36 § 1250.4(C) (2009); R.I. GEN. LAWS § 27-9.1-4(a)(16) (2008); S.D. CODIFIED LAWS § 58-33-67(1) (2008).

182. GA. CODE ANN. § 33-6-34(11) (2008); MO. REV. STAT. § 375.1007(13) (2008); NEB. REV. STAT. § 44-1540(14) (2008).

183. *E.g.*, R.I. GEN. LAWS § 27-9.1-4(a)(13) (2009).

184. *E.g.*, WASH. REV. CODE § 48.30.015 (2009).

Even more restrictive are time limits dictating when a claim must be settled or paid. In New Mexico and West Virginia, for instance, an insurer has ninety days to pay a claim after the insured files a proof of loss form.[185] In Connecticut, this period is only forty-five days,[186] and in Nevada and Wisconsin it is thirty days.[187]

While statutory deadlines can provide a useful benchmark for determining what is reasonable under the circumstances of a particular insurance claim, and can provide an incentive for insurers to act promptly, they should not, in the event of a missed deadline, necessarily trigger tort liability for bad faith. Rather, strict adherence to a statutory time period imposes a negligence per se rule. Such unbending application fails to provide latitude for reasonable excuses or other unintentional errors or miscommunications that ordinarily act to preclude a bad-faith action.

Strict adherence to time limitations as a basis for a bad-faith claim represents poor public policy for several reasons.[188] First, as mentioned above, such strict adherence diminishes the vital role of the jury in the civil justice system, and does so in perhaps the most suitable subject area for a jury to determine; that is, whether something sounds reasonable to an ordinary person. Second, a hard deadline removes any determination of culpability, such as whether the insurer intentionally acted to cause an unreasonable delay or denial of a claim; this determination is essential in evaluating the extent of liability and the amount of punishment necessary to deter similar acts in the future. Third, strict enforcement of a deadline for bad-faith purposes demonstrates a lack of understanding and an attempt at standardization in an industry where every insurance claim is different and requires varying levels of attention. Finally, and most importantly, strict enforcement of a statutory deadline provides an incentive for a claimant to abuse the insurance system, which is already rife with attempts at fraud.[189]

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185. N.M. STAT. ANN. § 59A-16-20(F) (2008); W. VA. CODE § 33-11-4(9)(o) (2008).

186. CONN. GEN. STAT. § 38A-816(15)(B) (2008). Connecticut's statute contains an exception to this deadline where the information provided under a claim is deficient.

187. NEV. REV. STAT. § 690B.012 (2009); WIS. STAT. § 628.46 (2008).

188. One type of strict time restriction, which exists in several states, applies to the payment of claims after the insurer has affirmatively acknowledged liability and should be viewed in a separate light. For example, in Hawaii and Maine, an insurer has thirty days to tender payment after accepting liability. *See* HAW. REV. STAT. § 431:13-103(11)(F) (2008); ME. REV. STAT. tit. 24-A § 2436(1) (2008). This situation is distinguishable because the claim-processing and investigation periods have terminated. The insurer has an undisputed liability, meaning it is less likely that there is a reasonable basis for not paying within the legislatively prescribed period.

189. *See supra* note 159 (noting the annual losses to the insurance companies).

If a claimant can prevail in a cause of action for bad faith whenever an insurer fails to meet a statute's arbitrary deadline, the claimant is more likely to engage in delay tactics or otherwise frustrate the insurer's claims-handling process.[190] Simple yet effective strategies include throwing out claims forms or other correspondence, changing a mailing address to delay actual receipt of forms, or providing deficient information to extend the investigation process. Where there is an ultimate deadline for payment, the claimant can bolster his or her bargaining position by unreasonably refusing to settle a claim for anything less than the policy limit.

A claimant may also be able to successfully lure an insurer into committing a bad faith violation by purporting to negotiate in good faith. For example, in *Berges v. Infinity Insurance Co.*,[191] the Florida Supreme Court permitted a bad-faith claim to proceed against an insurer where the insurer entered an agreement to pay the insured's policy limits within the required time deadline, but had not yet formally consummated the settlement and dispersed the money.[192] This occurred because the insurer could not forward actual payment until the claimant had the legal authority to execute releases on behalf of the estate and guardianship for the underlying wrongful death claim.[193] As one of the dissenting judges recognized:

> [T]here are strategies which have developed in the pursuit of insurance claims which are employed to create bad-faith claims against insurers when, after an objective, advised view of the insurer's claims handling, bad faith did not occur . . . . Obviously, this strategy worked well for the claimants and their attorneys in this particular case.[194]

The ease of proof, a missed deadline, also makes strict enforcement of these laws disconcerting. Statutes supposedly designed to facilitate reasonable investigation of insurance claims remove the court's ability to investigate what really occurred. Most of these time restrictions look only to whether the period has expired, and not to who caused the lapse; in doing so, the restrictions

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190. *See* Robert W. Emerson, *Insurance Adjusters and Plaintiffs' Attorneys: From Claims Fraud Consensus to Settlement Reform*, 30 AM. BUS. L.J. 538, 567–68 (1993) (noting that the ease with which claimants can pursue a bad-faith claim adversely impacts insurers' ability to investigate because they are working within shorter time constraints imposed by the claimant).
191. 896 So. 2d 665 (Fla. 2004).
192. *Id.* at 676.
193. *See id.* at 692 (Cantero, J., dissenting) (arguing that the majority placed the insurer in a tough position by giving it the option of forwarding payment to a person not authorized to execute a release or to be subject to a bad-faith lawsuit).
194. *Id.* at 685 (Wells, J., dissenting).

effectively encourage bad faith or unreasonable behavior by a claimant. This result is compounded by the lack of a reciprocal bad-faith action for insurers.[195] Instead, the insurer is left with little recourse other than a fraud action, which is a comparatively more difficult lawsuit to maintain and prevail in than a lawsuit where the insurer is only required to show a purposeful or reckless act by the claimant.[196]

To prevent such abuse, courts should refrain from overly mechanical application of statutory time periods for claims-handling and payment, and leave it to a trier of fact to construe an insurer's actions with a view as to the reasonableness of the insurer's actions under the circumstances. State legislatures, for their part, must also appreciate the unintended negative consequences that strict adherence to time limits can cause, and should provide express exceptions for reasonable delay.[197] Further, both courts and legislatures can avoid the destructive power shift of per se violations of claims-processing deadlines by applying the principles discussed in this Article. Namely, requiring intentional or reckless acts to maintain any bad-faith action, identifying exclusive enforcement by state regulators where a statute is ambiguous, refusing to use unfair claims settlement statutes as a proxy for common law actions, recognizing a right to cure, and permitting reverse bad faith actions would all help preclude abuse of hard deadlines for claims handling.

3. Courts should recognize meaningful exceptions to bad-faith statutes

A broader issue related to rigid time limits in insurance claims settlement statutes is the need for courts to recognize meaningful statutory exceptions to safeguard the interests of justice.[198] Because most claims settlement statutes establish liability for actions deemed unreasonable as opposed to intentional, courts should exercise a greater degree of leniency and understanding to the conditions faced by insurers. This is necessary, in part, to respect the fact that actions

195. *See* sources cited *supra* Part II.A.5 (arguing for a limited bad-faith action for insurers against claimants).

196. *See supra* notes 20–24 and accompanying text (explaining that bad-faith action developed for claimants as a result of the difficulty of maintaining a fraud action).

197. *See, e.g.*, WIS. STAT. ANN. § 628.46(2) (West 2004) (providing an exception for the thirty-day period in which the insurer must pay a claim where there is no recipient legally able to give a valid release for such payment or where the insurer is unable to determine who is entitled to receive payment).

198. This principle also incorporates many of the same justifications for a right to cure. *See supra* Part II.A.4 (arguing that insurers should have a right to cure a minor infraction to ensure that bad-faith law focuses solely on intentional, bad acts).

held unreasonable by courts enforcing a private statutory cause of action will likely trigger an additional penalty through state regulatory oversight.[199] Courts should, therefore, recognize exceptions where an insurer's actions are "fairly debatable" under the circumstances of a claim investigation,[200] or where an insurer's actions are reasonable but nevertheless lead to an incorrect outcome.[201]

A Mississippi Supreme Court case, *Employers Mutual Casualty Co. v. Tompkins*,[202] provides an example demonstrating the need to respect an insurer's reasonable, yet ultimately incorrect decisions. Although the case involved a common law action, the same principles of reasonableness discussed in this Article fit within the often more stringent confines of a state's statutes. In that case, an uninsured motorist backed out of her driveway and was struck by the insured defendant's motorcycle.[203] The insured filed an uninsured motorist claim with his insurer, and a claims adjuster initially denied the claim believing that the defendant's coverage applied only to the two cars listed on the policy.[204] Five months later, the insurer received a letter from the insured's attorney requesting further investigation and settlement.[205] An attorney for the insurer took over the claim investigation, and was advised by local counsel for the area where the accident took place that the effective policy limit was $20,000.[206] The insurer promptly offered $20,000, which was declined.[207]

199. *See supra* note 104 (citing a Rhode Island statute that establishes a damages range for each insurer violation up to $250,000).

200. *See, e.g.*, Robinson v. State Farm Mut. Auto. Ins. Co., 45 P.3d 829, 832 (Idaho 2002) (requiring the insured to prove as part of its prima facie case that the insurer's denial was not fairly debatable); Skaling v. Aetna Ins. Co., 799 A.2d 997, 1010 (R.I. 2002) (allowing the insurer to debate a claim that is fairly debatable).

201. The Nevada Supreme Court expressed this concern in *Powers v. United Services Automobile Ass'n*:

> A mere incorrect or "improper" denial of a claim is not tortious. A company may, in the utmost of good faith and propriety, deny a claim, only to have it proven later, in court, that its denial of the claim was improper and that the claimant was, indeed, entitled to indemnity. Under the instruction as given, all an insurance company would have to do to become liable to its insured for commission of the bad-faith tort would be to deny mistakenly a claim "without proper cause," that is to say, to deny a questionable claim that it should, properly, have paid—a rather common occurrence in the insurance world.

962 P.2d 596, 620 (Nev. 1998); *see also* O'Leary-Alison v. Metro. Prop. & Cas. Ins. Co., 752 N.E.2d 795, 799 (Mass. App. Ct. 2001) (refusing to hold an insurer's good-faith, but mistaken valuation of damages as a violation of the state's claims settlement statute).

202. 490 So. 2d 897 (Miss. 1986).

203. *Id.* at 898–99.

204. *Id.* at 900.

205. *Id.*

206. *Id.* at 901.

207. *Id.*

The insured's attorney responded with a demand for $50,000 to be paid in five days or a lawsuit would commence alleging compensatory and punitive damages.[208] The insurer then sought a declaratory judgment in federal court to determine the correct policy limit.[209] When the court found that the effective limit was $50,000, the insurer immediately offered that amount, which was refused as well.[210]

The subsequent bad-faith lawsuit resulted in $50,000 in compensatory damages and $400,000 in punitive damages against the insurer.[211] The jury also found that the uninsured motorist, who was joined in the action, was modestly negligent and returned a verdict of only $500.[212] Rather, the insured, who sustained serious injuries, was held to have contributed heavily to the accident.[213] In other words, because the insured was the primary cause of his accident, "the insurer would have had ample reason to dispute the claim vigorously and to question whether any payment was due *even if it recognized $50,000 in coverage from the outset*."[214]

Although the Mississippi Supreme Court ultimately reduced the compensatory award to $500, yet affirmed the punitive damages award on the ground that the insurer should not have included an ambiguous and invalid exclusion provision in its contracts,[215] the case illustrates how a trial court can unreasonably punish an insurer. True, the insurer was incorrect, but when made aware of its error the insurer twice offered what it reasonably believed to be the policy limit, and did so in a case in which it might not have been obligated to pay at all.

In situations where the insurer's actions prove incorrect, compensatory relief is the appropriate remedy, including any interest and attorneys' fees for the delay caused by litigation.[216] However, additional penalties for bad faith, like punitive damages, are unjustified where misjudgment or miscalculation provides the basis for an unreasonable delay or denial of a claim. While the common law of most states rejects such bad-faith claims by requiring

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208. *Id.*
209. *Id.*
210. *Id.*
211. *Id.*
212. *Id.*
213. *Id.* at 901–02.
214. William T. Barker & Paul E.B. Glad, *Use of Summary Judgment in Defense of Bad Faith Actions Involving First-Party Insurance*, 30 TORT TRIAL & INS. PRAC. L.J. 49, 79 (1994) (emphasis in original).
215. *Tompkins*, 490 So. 2d at 903.
216. *See, e.g.*, OKLA. STAT. ANN. tit. 36 § 3629 (West 1999) (prescribing a fifteen percent annual rate of interest for bad-faith claims settlement beginning from the date the loss was payable until the date of the verdict).

intentional unreasonable delay or denial, statutes giving rise to a private right of action may lack this standard. Hence, courts interpreting statutory private rights of action should, as routine practice, recognize exceptions that protect the right of the insurer to contest a claim without malice, and occasionally be incorrect.[217]

4. *Comparisons to insurer offers and amounts ultimately recovered through litigation represent poor policy for allowing bad-faith claims to proceed*

The need for courts to articulate meaningful exceptions to bad-faith statutes is particularly evident with regard to a common provision in the statutes of most states that compares an insurer's settlement offer with the amount ultimately awarded through litigation. The provision typically states that an insurer cannot engage in a practice of offering claimants "substantially less" than the amount ultimately recovered in a lawsuit.[218] As an indicator of bad faith, this provision is over-inclusive and misleading, and as policy, unjust and oppressive. The insurer can effectively be punished for acting reasonably and in good faith at all times.

Choosing to litigate an insurance claim is a costly undertaking for an insurer, regardless of the economies of scale an insurer might possess. There are attorneys' fees and other unavoidable costs, and the outcome is uncertain. Insurers are also not blind to the poor public perception of their industry; a perception that contributed to the creation of tort liability in insurance contracts where it does not exist in other contexts.[219] The prospect of paying extra-contractual damages, especially punitive damages, is itself daunting; this daunting prospect is enhanced by the insurer's position as an unpopular defendant and the belief of many juries that insurers have deep

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217. A number of state statutes include express exceptions for claims delays where the insurer is conducting or cooperating with an investigation into arson or fraud. *See, e.g.*, MINN. STAT. ANN. § 604.18(2)(c) (West Supp. 2008) (creating an exception where the insurer is conducting or cooperating with a timely investigation into arson or fraud). Such a caveat is important to respecting an insurer's ability to reasonably contest or investigate suspect claims without being pressured into paying the claim to avoid a bad-faith lawsuit, especially in the event that the insurer's reasonable suspicion ultimately does not evidence arson or fraud.

218. *See, e.g.*, IND. CODE ANN. § 27-4-1-4.5(7) (LexisNexis 1999) (allowing insureds to recover amounts due under an insurance policy when the insurer offers substantially less than the amount ultimately recovered in a lawsuit).

219. *See, e.g.*, Dickinson v. Land Developers Constr. Co., 882 So. 2d 291, 304 (Ala. 2003) (Houston, J., concurring) (observing that outside of the insurance context, parties to a contract may breach even in bad faith without being subject to liability for fraud or bad-faith tort unless the fraud is perpetrated in inducing a party to enter a contract); Recycleworlds Consulting Corp. v. Wis. Bell, 592 N.W.2d 637, 643 (Wis. Ct. App. 1999) (refusing to permit punitive damages or tortious breach of contract where the underlying cause of action is breach of contract).

pockets and can afford it.[220] In addition, any plaintiff verdict could lead to negative press, which could cause existing policyholders to change insurers or could deter future customers. A particularly high damage award could also provide harmful precedential value and inflate other award amounts. For these reasons, insurers are poised to settle claims they reasonably believe they will lose, as well as some they believe they should win. Settlement simply becomes the better option.[221]

The high degree of caution insurers exercise before turning to litigation as a last resort is both reasonable and in the insurer's self-interest. Quite simply, there is no rational incentive for the insurer to "low-ball" a final settlement offer and then proceed with litigation it believes it will lose. Yet claims settlement statutes do not consider these practical mechanics, nor do they search out intentional and reckless behavior.[222] They look only to the magnitude of difference between settlement and verdict.

A reality of any civil justice system is that juries may return disproportionate awards.[223] Also, the insurer's internal calculation of the merits and costs associated with a case may be flawed as they are based on imperfect information. Indeed, critical questions like the permissible limits of punitive damages awards are still being fleshed out.[224] The result is that an insurer may be confronted with a higher verdict than it reasonably, and presumably in good faith (if acting in its own self-interest), anticipated. The difference between the final settlement offer and the verdict is then expected to be substantial in amount. This outcome is predetermined by the insurer's initial decision to litigate, and it is this outcome that provides the frequency

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220. *See* TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 491 (1993) (O'Connor, J., dissenting) (arguing that because corporations represent large accumulations of wealth, juries may be more inclined to award large judgments to what they perceive as "needier plaintiffs").

221. *See* Barker, *supra* note 214, at 49 (noting that insurers may settle in an attempt to avoid sympathetic juries that may award inflated damages).

222. *See, e.g.*, OKLA. STAT. ANN. tit. 36 § 3629 (West 1999) (imposing a duty on insurers to submit a written offer of settlement or rejection within ninety days of receipt of proof of loss without exception).

223. *See* Exxon Shipping Co. v. Baker, 128 S. Ct. 2605, 2625 (2008) (reasoning that the core problem with punitive damages awards is not frequent, excessive awards, but rather the unpredictability with which they are awarded).

224. *See id.* at 2633 (determining that a one-to-one ratio of punitive damages to compensatory damages provided the appropriate limit under admiralty common law for the environmental damages caused by an oil tanker spill); Phillip Morris USA v. Williams, 549 U.S. 346, 353 (2007) (holding that a multi-million dollar punitive damages award against a cigarette manufacturer violated procedural due process); State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408, 425 (2003) (holding that a $145 million punitive damages award based on $1 million in compensatory damages resulting from insurance bad faith exceeded due process boundaries).

or pattern of substantially disparate amounts necessary to maintain the statutory action. Taking this to its logical conclusion, the insurer, to avoid a statutory action for offering "substantially less than the amounts ultimately recovered," should never choose to litigate a claim—an unrealistic and untenable argument that would supersede the basic objective of protecting against fraud and overpayment in insurance claims-handling.[225]

Comparing the final settlement offer to the amount recovered is also unsound policy because it amounts to an additional level of punishment where the insurer has previously been punished. For the difference between an insurer's final settlement offer and verdict to rise to an amount characterized as "substantial," it can be assumed that the insurer paid some level of extra-contractual damages. As addressed earlier with regard to the potential for double punishment in bad-faith actions, tort liability, punitive damages, and regulatory penalties can operate to inflict multiple levels of damages beyond the policy limit of the insurance contract.[226] Permitting additional tort liability, including the possibility of a second punitive damages award, where the basis for that recovery is in part due to the high magnitude of the original award, is excessive. It is also wholly unjustified where the insurer's incentive to act reasonably is already aligned with its self-interest.

Courts interpreting these statutory bad-faith provisions have reasonable options to mitigate injustices, while holding true to the letter of these laws. First, courts can limit excessive extra-contractual awards, like punitive damages, to indirectly lessen substantial differences between settlement and verdict. For instance, in *Exxon Shipping Co. v. Baker*,[227] the Supreme Court recently recognized, under admiralty law, a one-to-one ratio of punitive damages to compensatory damages as the permissible limit for a compensatory award.[228] Second, courts could more directly identify unreasonable insurer conduct by interpreting the "amounts ultimately recovered" as those compensatory amounts recovered, and by using that

225. A stronger public policy argument for the comparison between a settlement offer and a final award exists where the insurer's final settlement offer is less than the policy limit and will require the insured to pay out-of-pocket expenses. However, the law already finds this practice to be a form of bad faith. *See supra* notes 26–28 and accompanying text (discussing extra-contractual duties to settle third-party claims including situations where an insurer refused to defend the claim within the insured's policy limits).

226. *See supra* Part II.A.2 (arguing that courts should refrain from permitting bad-faith actions because it leads to duplicative penalties).

227. 128 S. Ct. 2605 (2008).

228. *Id.* at 2633.

interpretation as the basis for comparison. This provides a more objective measure of the reasonableness of a final settlement offer and avoids less-defined damages standards and determinations that may be rooted more in bias against insurers than in fact. Insurers can reasonably and in good faith miscalculate a case, and it is up to courts to protect and not penalize this possibility.

5. *Principles for the statutory recovery of attorneys' fees in bad-faith actions*

The final subject in this analysis on the law of bad faith concerns provisions for attorneys' fees. A number of states have found exceptions to the so-called "American Rule,"[229] which requires that each party bear the cost of its litigation, and expressly provide recovery for attorneys' fees in bad-faith insurance statutes.[230] These laws typically state that the claimant may be awarded a "reasonable" fee amount, but they fail to address the scope of compensable fees. For instance, attorneys may attempt to recover fees associated with recruiting other plaintiffs to join a bad-faith lawsuit, fees for time spent developing bad-faith arguments that will be attempted in future cases—and not in the prevailing plaintiffs' individual case—or more commonly, fees for their prosecution of the contract-coverage dispute generally rather than the purported bad faith.

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229. *See, e.g.*, Goodover v. Lindey's Inc., 843 P.2d 765, 774 (Mont. 1992) (stating that absent statutory or contractual provision, attorneys' fees will be limited to situations where a party has been forced into a frivolous lawsuit and must incur the fees to dismiss the claim); Barnes v. Okla. Farm Bureau Mut. Ins. Co., 11 P.3d 162, 180 (Okla. 2000) (creating exceptions to the American Rule where an opponent in litigation has acted in bad faith, vexatiously, or for oppressive reasons).

230. *See, e.g.*, ARIZ. REV. STAT. ANN. § 12-341.01(A) (West 2001) (awarding attorneys' fees to a defendant where the settlement offer is greater than the verdict); IDAHO CODE ANN. § 41-1839(4) (2002) (where the suit has been pursued or defended frivolously); ME. REV. STAT. ANN. tit. 24-A § 2436 (West 2000) ("reasonable" attorneys' fees provision if overdue benefits are recovered in an action against the insurer); OKLA. STAT. ANN. tit. 36 § 3629 (West 1999) (providing attorneys' fees to the prevailing party); S.C. CODE ANN. § 38-59-40 (West 2002); S.D. CODIFIED LAWS § 58-12-3 (West 2004) (prevailing insured is entitled to fees if it establishes that insurer's refusal to pay or defend is "vexatious or without reasonable cause"); VA. CODE ANN. § 38.2-209(A). Similarly, states such as Colorado and Ohio rely on more general statutes to permit the award of attorneys' fees for bad faith. *See* COLO. REV. STAT. ANN. § 13-17-101 (2008) (allowing attorneys' fees to address the problem of excessive litigation); OHIO REV. CODE ANN. § 2721.16 (LexisNexis 2005) (granting attorneys' fees on equitable principles in claims for declaratory relief). A number of states have also recognized the need to protect a claimant's ability to challenge the allegedly wrongful acts of insurers, and permit recovery for attorneys' fees under common law. *See* ACMAT Corp. v. Greater N.Y. Mut. Ins. Co., 923 A.2d 697, 705 (Conn. 2007) (observing that nine states (Indiana, Iowa, Maine, Mississippi, North Carolina, Pennsylvania, Utah, Vermont, and Wisconsin) have created common-law exceptions where the litigation is the result of the bad faith of the insurer).

Recovery of attorneys' fees is inappropriate in these cases because the fees are not directly associated with the claimant's bad-faith suit.[231] In the absence of practical guidelines, insurers run the risk of over-compensating claimants' attorneys. Thus, as a general principle, courts should limit the recovery of attorneys' fees to those fees associated with the demonstrated statutory violation from which the plaintiff prevails.

Such fairness in litigation can be achieved through relatively unobtrusive means. A court could require a sworn statement by the attorney separating the fees spent on the claimant's bad-faith claim from those spent on attenuated matters, or, at least, require a good-faith estimate of the bad-faith fee allocation if specific records are unavailable. Courts might also require that bad-faith claimants keep records in order to ensure a just accounting of fee awards.

In states like Illinois, the legislature has indirectly safeguarded against over-compensation for attorneys' fees recovery by limiting the total fee award to the greater of sixty percent of the jury's award or $60,000.[232] However, as another general principle, courts should base an award of attorneys' fees not on what a jury returns, but rather on the final judgment of the court.[233] This is especially important in contingency fee agreements—which are common in bad-faith litigation—because basing the fee on the final judgment protects against the consequences that follow when a percentage fee award is based on a verdict amount that is subsequently held to be excessive.

Minnesota's newly enacted statute governing attorneys' fees in insurance bad-faith cases provides a good example of a carefully constructed law. The law limits the fee award to "reasonable attorney fees actually incurred to establish the insurer's [bad-faith] violation" and states that the fees "may be awarded only if the fees sought are separately accounted for by the insured's attorney and are not duplicative of the fees for the insured's attorney otherwise expended in pursuit of proceeds for the insured under the insurance policy."[234] The statute further caps the maximum fee award at $100,000.[235]

231. *See* Taylor v. State Farm Fire & Cas. Co., 981 P.2d 1253, 1258 (Okla. 1999) (interpreting the scope of the state's general attorney's fees statute in a bad-faith insurance action to award fees on the recovery of the insured's loss and not on the theory of liability).

232. 215 ILL. COMP. STAT. ANN. § 5/155(1)(b) (LexisNexis 2007).

233. *See, e.g.*, Vest v. Travelers Ins. Co., 753 So. 2d 1270, 1276 (Fla. 2000) (holding that bad-faith claims do not accrue prior to the approval of settlement); Allstate Ins. Co. v. Sutton, 707 So. 2d 760, 761 (Fla. Dist. Ct. App. 1998) (requiring that any attorneys' fees award be based on the court's final judgment).

234. MINN. STAT. ANN. § 604.18(3)(a)(2) (West Supp. 2008).

235. *Id.*

The insurer is, therefore, still penalized for its bad-faith violation, but that additional penalty is directly related to the specific offense and is limited to protect against inappropriate or excessive fee awards.

The decision to break from traditional rules and to award attorneys' fees in insurance bad-faith cases is one appropriately left to state legislatures.[236] Where the insured's payment of attorneys' fees is out-of-pocket, the circumstances appear most compelling in favor of fee shifting; however, the prevalence and availability of contingency fee arrangements in which the insured is not required to front monies to maintain a claim may effectively remove this barrier to sue. Yet, regardless of the fee arrangement or public policy rationales, courts, by more precisely defining the scope of fair compensation for attorneys, can improve the efficiency and justice in the civil system.

III. PUBLIC POLICY FAVORS MORE PRINCIPLED APPLICATION OF BAD-FAITH LAWS

Expansion of bad faith has, contrary to the assertions of some legal experts over a decade ago,[237] not reached "maturity." Multi-million dollar extra-contractual awards for bad faith are increasingly commonplace,[238] and the state of the law reveals inconsistencies in structure, standards, and application,[239] many of which have been aggressively targeted or manipulated to the detriment of insurers.[240]

236. Commentators have identified four areas where legislatures and courts have found an exception to the American Rule: (1) where the losing party has acted in bad faith; (2) where the litigation results in the creation or enhancement of a common fund from which attorneys' fees can be paid; (3) where the litigation provides a "substantial benefit" to a certain class of people; and (4) where the litigant has served as a "private attorney general" in righting some constitutional or statutory wrong. *See generally* Miotke v. City of Spokane, 678 P.2d 803, 820–22 (Wash. 1984) (en banc) (listing four recognized grounds for an exception to the general rule: bad faith, common fund, protection of constitutional principles, and private attorney general); Karla H. Alderman, *Making Sense of Oregon's Equitable Exception to the American Rule of Attorneys' Fees After* Armatta v. Kitzhaber, 35 WILLAMETTE L. REV. 407, 417–18 (1999) (referencing bad faith, common fund, substantial benefit, and private attorney general as four exceptions to the American Rule); John F. Vargo, *The American Rule on Attorney Fee Allocation: The Injured Person's Access to Justice*, 42 AM. U. L. REV. 1567, 1584 (1993) (discussing exceptions to the American Rule, including common fund, substantial benefit, and bad faith).

237. *See, e.g.*, Kenneth S. Abraham, *The Natural History of the Insurer's Liability for Bad Faith*, 72 TEX. L. REV. 1295, 1295 (1994) (arguing that a reduction in bad-faith lawsuits has resulted in a lessened threat to insurers as well as a lessened incentive to plaintiffs who bring bad-faith lawsuits).

238. *See supra* note 1 and accompanying text (noting recent trends pointing to an increase in bad-faith litigation).

239. *See supra* Part I (observing that while there are often substantial similarities in bad-faith statutes, there is inconsistency in judicial interpretation of these statutes).

240. *See supra* note 57 and accompanying text (comparing the gap in interpretation between the legislature and courts of Colorado).

While the overriding purpose of bad-faith laws is to safeguard the interests of claimants—an assuredly valid and worthwhile objective—the law in certain instances has gone too far and has deviated from the goal of bad-faith claims. Insurers can be punished for reasonable actions even where the law purports to require a culpable offense.[241] Similarly, any insurer mistake, reasonable or unreasonable, may be punished severely regardless of whether there was an actual intent to engage in bad faith. As a basic matter of fairness and justice, this result is unacceptable.

The principles outlined in this Article seek to redress areas of abuse and restore a much needed sense of balance in the law of bad faith. At the same time, these principles seek to provide greater substance and form to the meaning of bad faith, and enhance the efficiency and effectiveness of the insurance claims-processing system. Establishing a more just system of compensation and curbing the flow of improper claims reduces the costs of insurance. This benefits the overwhelming majority of insureds and also permits the entry of new consumers into the insurance market who were previously priced out. In comparison, allowing bad-faith litigation to continue to expand to less culpable insurer practices provides only a small fraction of claimants with a windfall recovery. Tort litigation is a costly and imprecise enforcement tool useful only in limited instances where an insurer willfully schemes to deny compensation to a claimant or to intentionally delay payment. It is rendered even less necessary where, as in the practice of insurance, other market forces exist to provide substantial disincentives for acting in bad faith.

A. Market Forces Demand That Insurers Self-Regulate

By any account, the insurance industry is massive in scale. In 2008 alone, insurers collected over $4 trillion in premiums globally.[242] With such an incredible potential market, it is not surprising that the industry is extremely competitive. National insurers such as Geico, Progressive, Allstate, and State Farm each spend hundreds of millions of dollars every year advertising directly to consumers.[243] Often, the

241. *See supra* Part II and accompanying text (discussing excessive penalties, the one-sidedness of bad-faith litigation, and the dangers of finding liability where there is none).

242. Insurance Information Institute, International Insurance Fact Book, http://www.iii.org/international/overview/ (last visited July 27, 2009).

243. *See* Lavonne Kuykendall, *Geico Advertising Spending Tops Among Auto Insurers in '06*, DOW JONES NEWSWIRES, Sept. 19, 2007, *available at* http://insurance headlines.com/Auto-Insurance/3882.html (listing the auto-insurance advertising expenditures of the top four national insurers and estimating that auto-insurance advertising alone would exceed $1.7 billion for 2007).

goal of these advertisements is not to solicit new, uninsured customers, but rather to convince another insurer's customers to switch providers. Smaller, local insurers also have a role in this heavily fragmented industry, finding more niche areas of property coverage or even competing with national insurers on price. In such a highly competitive environment, and given the standard function of insurance, the two primary means of differentiation for an insurer are price and quality of service.

For insureds, this high level of competition represents a much improved bargaining position. Out of necessity, insurers now cannot afford to engage in any action that could be construed as bad faith. This result is independent of tort liability or the threat of tort litigation. Included in the insurer's quality of service is its reputation, and consumers are unlikely to continue purchasing insurance from an insurer who they, by word of mouth or through other channels, perceive to be dishonest or unreputable. With many available alternatives at their fingertips, insureds can easily, and at nominal cost, change insurers within minutes in many instances.[244] The fact that consumers have this degree of bargaining power to enter and exit insurance transactions also undercuts the basic public policy argument favoring recognition of tort liability that insurance, by its nature, places the insured in a position of unequal bargaining.[245]

The inevitable conclusion to be drawn from market competition, independent of existing governmental regulation, is that insurers must self-regulate their own conduct to survive. As briefly addressed earlier with regard to comparisons of final settlement offers to amounts ultimately recovered in bad-faith lawsuits, it is not in the

244. *See, e.g.*, Geico Insurance, www.geico.com (last visited June 28, 2009) (advertising that fifteen minutes can save fifteen percent or more on car insurance).

245. *See, e.g.*, Arnold v. Nat'l County Mut. Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987) (arguing that insurance contracts are unique because of inherently unequal bargaining power between the insurer and insured, and thus bad-faith actions should be maintained to prevent insurers from arbitrarily denying coverage or forcing insureds to prematurely settle their claims); *see also* United Fire & Cas. Co. v. Boulder Plaza Residential, L.L.C., No. 06-cv-00037-WYD-CBS, 2008 WL 2078114, at *5 (D. Colo. May 13, 2008) (stating that courts construe ambiguous provisions against the insurer and in favor of providing coverage because of the unique nature of insurance); Barrera v. State Farm Mut. Auto. Ins. Co., 456 P.2d 674, 681–82 (Cal. 1969) (finding that the quasi-public nature of insurance forces courts to look beyond the rules of private contracts negotiated by parties of relatively equal bargaining strength); Ill. Farmers Ins. Co. v. Glass Serv. Co., 683 N.W.2d 792, 802 (Minn. 2004) (referring to insurance as "quasi-public" and that it should be within a state's police power to regulate); Wathor v. Mut. Assurance Adm'rs, Inc., 87 P.3d 559, 562 (Okla. 2004) (arguing that the quasi-public relationship creates a nondelegable duty of good faith and fair dealing on the part of the insurer).

financial self-interest of insurers to engage in bad faith.[246] The benefits of intentionally delaying or denying a claim do not outweigh the risk that even one of those cases will result in full contract damages, extra-contractual damages, punitive damages, state regulatory fines, attorneys' fees, and future compliance costs.

Paradoxically, these incentives have not reduced bad-faith litigation. Quite the contrary has occurred.[247] This increase in the number and size of claims suggests that insurers are either brazenly ignoring and flouting the law of bad faith, which is clearly against their rational self-interest, or, more realistically, that the law is inappropriately and increasingly punishing insurers for unintentional acts, such as reasonable denials of claims, mistakes, or other minor violations. The market of insurance already provides a sizeable reward for those insurers who can best minimize mistakes, avoid bad-faith lawsuits, and offer superior service. The penalty for an insurer's failure to do so is forcible exit from the market. The market system, along with the additional level of protection provided by state regulatory enforcement, can and should be relied upon to fairly protect claimants. Litigation as a means to safeguard claimants should become increasingly irrelevant.

B. Implications of Permitting Improper Bad-Faith Claims

Proponents of expanding private enforcement of bad-faith law through greater statutory enumeration of alleged types of bad faith, heightened penalties, or lower standards to maintain a claim, routinely justify this advocacy on the grounds that any change in the law will only impact "bad" insurers. A parallel situation would be that increased health code standards only impact poorly managed restaurants. The fallacy in this argument is that when expanding the law to include less culpable offenses, the law will eventually implicate every insurer's actions, good or bad. Premiums will rise. Policyholders will suffer the costs.

When the law begins to punish insurer's unintentional acts, the foundations of the insurance system break down and the incentive structures change. Quick settlements at higher, even unjustified prices become encouraged so that insurers can avoid lawsuits. Also, financial incentives and rewards for insurers that provide superior services are diminished if the market effectively punishes

246. *See supra* Part II.B.4 (observing that the fears and costs of litigation often force insurers to prematurely settle claims that may be invalid).

247. *See supra* note 1 and accompanying text (noting recent trends pointing to an increase in bad-faith litigation).

insurers when they are trying to be good. The insurance industry's best providers are inappropriately placed on equal or comparable footing with insurers that would ordinarily be expelled from the industry due to market forces.

Moreover, a lack of rational boundaries in bad-faith law harms all consumers. Permitting extra-contractual damages awards in cases that should not appropriately be settled does not serve a useful purpose. It provides a windfall recovery to claimants based on events such as human error or reasonable miscalculation, and appeals to the biases that juries maintain against insurers. In the end, the insurance consumer pays these superfluous costs. Insurers internalize the systemic risks of bad-faith litigation and raise premiums accordingly. Because this happens, in part, on an industry-wide level, the increase in cost occurs independent of a specific insurer's risks of bad-faith litigation and does not distinguish the truly "bad" insurers from those who are trying, admittedly without perfection, to be responsible.

Increases in insurance costs, in turn, contribute to a range of societal problems. Presently in the United States, high insurance premiums price large populations out of the market. Forty-five million Americans, or one out of every seven persons, do not have health insurance.[248] There are also millions of uninsured or underinsured motorists driving in the streets;[249] these persons are left wholly unprotected in the event of an accident, and the costs of coverage for insured motorists increase as a result. For example, in Texas alone, there are an estimated three to four million uninsured motorists out of the state's sixteen million drivers.[250] As a policy tradeoff, the benefits of placing rational limits on bad-faith lawsuits and reducing system costs far outweigh the costs of additional compensation to individual claimants for less culpable insurer acts. This is because the state insurance department already imposes a penalty on these acts, and because private claims may be addressed through traditional contract theory.

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248. Press Release, United States Census Bureau, Census Bureau Revises 2004 and 2005 Health Insurance Coverage Estimates (Mar. 23, 2007), *available at* http://www.census.gov/Press-Release/www/releases/archives/health_care_insurance/009789.html.

249. *Cf. Road Hazard: Uninsured Driver Rates Climb*, ASSOCIATED PRESS, Feb. 10, 2009, *available at* http://www.insuranceheadlines.com/Auto-Insurance/5595.html (reporting an estimated increase of three million more uninsured drivers in the last five years).

250. Terrence Stutz, *3 Years After Law, Texas Will Target Uninsured Drivers*, DALLAS MORNING NEWS, May 8, 2008, *available at* http://www.dallasnews.com/sharedcontent/dws/dn/latestnews/stories/050808dntexuninsured.dbf3df87.html.

As proposed throughout this Article, the most efficient enforcement system for insurance bad faith is to allow private lawsuits where claimants can prove an intentional or reckless act on the part of the insurer. In any other violation arising under a claims settlement statute, the state's insurance regulatory authority should exercise exclusive jurisdiction. This clearer structure would prevent dual-enforcement and double-punishment against insurers, while still adequately safeguarding the interests of claimants and consumers at large. It would also sustain the heavy market competition that improves consumers' bargaining power and necessitates self-regulation by insurers.

If bad-faith law continues on its present course, the implications are adverse to all parties' interests. Responsible and ethical insurers will find it harder to differentiate from one another and compete, claimants will be more susceptible to dishonest acts, and the system costs will continue to increase, harming all consumers. Also troubling, consumers may perceive an insurer's inundation of bad-faith claims and resulting high verdicts as an ordinary industry practice. They may become apathetic to an insurer's service reputations, severely inhibiting the market system's repudiation of bad insurers, and they may differentiate insurers only with regard to price. Worse, consumers might begin to tolerate bad faith as inherent to the insurance business, perpetuating the flow of improper litigation and exacerbating biases against insurers.

CONCLUSION

The law of bad faith has witnessed an extraordinary, unprecedented development in the past three decades.[251] What began as a court's novel attempt to level the playing field in insurance claims-handling is now enshrined in the common law or legislative code of every state. The speed at which this law became so firmly rooted, however, left important issues outstanding. Before the common law evolved to address and refine this newly independent and amorphous tort concept of bad faith, claims settlement statutes were enacted across the country. The result was greater inconsistency and uncertainty in the law, which was then magnified by courts' widely varying statutory interpretations. The law that sought to balance the insurance equation suddenly became unbalanced.

251. *See* Henderson, *supra* note 19, at 1 (noting that the development of bad-faith law is noteworthy because courts have only recognized three or four new torts in the past century).

Caught on the unenviable side of the scale were insurers. While the new laws operated to punish bad acts, plaintiffs' attorneys gradually recognized that less reprehensible acts, even reasonable acts, were fair game in some jurisdictions. At the same time, remedies were expanded, and continue to expand today as many states reexamine their bad-faith statutes. The law thus shows little evidence that bad-faith litigation has leveled off or reached maturity. Rational boundary lines must be drawn, and the responsibility falls on both state legislatures and state courts.