Beyond Bad Faith: Expanding Bad Faith Damages Fraud-Fighting

New Jersey joins national trend of states pushing the limits of bad-faith liability, with potentially devastating results.

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Look closely … A trend is emerging. While we were all distracted, navigating the ever-shifting terrain of pandemic life, courts and legislatures moved forward with attempts to hinder fraud-fighting.

From coast-to-coast, states are lowering the threshold for bad faith exposure while stiffening penalties for violations. They seek to punish "unreasonable" decision-making while allowing penalties well in excess of the policy limits. With often broad definitions of the term "insurer," the plaintiff's bar is actively pursuing actions directly against claims handlers.

Consequently, insurance representatives are left to face a new reality. Standards that are potentially much higher than "good faith" have a very real possibility of personal liability for failing to meet those new re-quirements. Such an environment could lead to a greater incidence of insurance fraud as claims handlers feel pressure to simply pay questionable claims rather than to utilize investigative tools.

As with any industry turmoil, insurance consumers may ultimately be the ones burdened by the changes. Even laws with tight controls on premium increases will place a higher financial strain on insurance companies through greater compliance, additional training costs, and a higher incidence of fraud. The result would be a less-attractive environment for high-quality insurers to do business in the affected states.

Now is the time that insurers must awaken to this new reality and prepare how to best conduct investigations and claims handling in this new legal landscape.

Law follows flawed premise

New Jersey became the latest state to enact extra-contractual exposure through the signing of the Insurance Fair Conduct Act (IFCA) on Jan. 18, 2022.[1]

The statute allows first-party Uninsured Motorist (UM) and Underinsured Motorist (UIM) claimants to file suit directly against their insurance carriers for "unreasonable" delays or denials or for any violation of the Unfair Claims Settlement Practices Act (UCSPA). Successful plaintiffs can be awarded damages up to three times the available coverage limit. Any added costs associated as a result of compliance with the act cannot be passed onto the policyholder through rate increases.

The impetus for the statute appears straightforward: deter and penalize any indicia of bad conduct by insurers. This motivation was echoed by the bill's sponsor, who indicated that the statute will help to protect consumers from the unfair business practices of insurance companies and provide them with a mechanism to "fight back."[2]

The legislature's goals appear three-fold: lower the threshold to file lawsuits against the insurance companies; strengthen the penalties for bad-actors; and contain the threat of increased premiums by virtue of compliance. In simplest terms, the statute seeks to "even the playing field" between the disadvantaged consumer and the powerful insurance industry.

Arguably, however, the very premise of the legislation is flawed. That is, New Jersey insurance consumers already had two important resources to "fight back" against their insurance carriers long before the signing of the IFCA.

The private right to sue your own insurer for "bad faith" practices has existed in New Jersey since the seminal 1993 Supreme Court decision, *Pickett v. Lloyds*.[3] The *Picket* court defined bad faith as a "denial or a withholding of benefits for reasons that are not even debatably valid." To show a claim for bad faith, the court explained, a plaintiff must demonstrate the absence of a reasonable basis for denying policy benefits and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. In short, *Pickett* granted insurance consumers the ability to fight back against alleged bad-faith claims-handling by their insurers.

On the administrative side, New Jersey insurers have been tightly regulated for decades by virtue of the UCSPA. The consumer protection law allows the Commissioner of Insurance to take administrative action against insurers whose general business practices are found to be improper.[4]

The IFCA expands on both of the above protections. Where previously consumers had a shield, they now have a sword.

Act is vague about what is "unreasonable"

Unlike in *Pickett*, the IFCA does not require a "reckless disregard" on behalf of the insurer. Instead, any "unreasonable" delay or denial can result in a lawsuit. Since the act offers no definition of the term "unreasonable," insurers will be left to speculate what reasonableness means in this context. For example, is a denial reasonable when the law on a particular issue remains unsettled? How soon is it reasonable to issue a response to a claim? How fact-sensitive will the analysis be?

While violations of the USCPA are only enforceable by the Commissioner of Insurance, the IFCA creates a private right of action for any violation of the regulation. The threshold for determining an infraction has likewise been eroded. The USCPA required a demonstration that violations occurred so frequently to show a "general business practice" on the part of the carrier.

The IFCA explicitly removes that requirement. Now an insured can file suit over such infractions as: a misrepresented policy limit, a representative's failure to promptly investigate a claim; or failing to promptly provide a basis in facts or law of a claim

denial. There are over a dozen enumerated potential violations.

Finally, and perhaps most concerning, the IFCA's definition of an "insurer" may be sufficiently vague to encourage the plaintiff's bar to sue insurance representatives personally for their claims decisions. The law defines an "insurer" as any "individual … which issues, executes, renews or delivers an insurance policy in this State, or which is responsible for determining claims made under the policy." Though we believe that New Jersey courts will likely find that the law was written to only penalize insurance companies, and not individuals, this still remains an area of concern.

As we will see, similar such definitions have already placed claims representatives squarely in the crosshairs of aggressive plaintiff's attorneys in other states.

The IFCA presents a host of new challenges in handling UM & UIM matters. The scope of the changes will remain unclear until the legislation is fully interpreted by New Jersey's courts.

Since the law takes effect immediately, insurers do not have the benefit of standing on the sidelines and waiting for such answers. Action is required now. With this idea in mind, it is important to take a step back and look at how these issues are playing out on a national stage.

Bad faith expanding in other states

New Jersey's IFCA is just the latest example of this push to extend the bounds of extra-contractual liability.

Consider the State of Washington's identically named "Insurance Fair Conduct Act."[5] Aside from their titles, the substance of the laws is remarkably similar. Washington's version of the IFCA applies to "any first party claimant to a policy of insurance who is unreasonably denied a claim for coverage or payment of benefits by an insurer may bring an action in the superior court …" Violations of the statute may result in awards of treble damages, attorney fees and litigation costs.

As with the New Jersey iteration, Washington's IFCA suffers from loosely defined statutory language that leaves it vulnerable to unintended interpretations.

The statute provides that a "person" who violates the duty of good faith in all insurance matters may be liable for the tort of bad faith. The term "person" is defined as "any individual, company, insurer, association, organization, reciprocal or interinsurance exchange, partnership, business trust, or corporation."

In the now infamous 2018 decision *Keodalah v. Allstate Ins. Co.*, a Washington appellate court interpreted the above IFCA language to find that a claims representative could be sued personally for bad-faith claims handling.[6]

This was a shocking result. Bad faith was no longer just a financial hazard for the company; individual adjusters were also vulnerable.

A year later the Washington Supreme Court granted an appeal. By a narrow 5-4 margin, and a vigorous dissent, the appellate court's finding was overturned. The Court reviewed both the statutory language and the broader legislative intent before ruling that there was

no private right of action against claims adjusters.[7]

The near miss in Washington emboldened the plaintiff's bar. Attorneys in similarly regulated jurisdictions recognized there was an opportunity to shift the legal protections of front-line claims handlers to their own advantage.

In short order, the issue resurfaced in Colorado. In the yet-to-be-decided matter of *Skillet v. Allstate*, an insured sued an insurance investigator for allegedly breaching Colorado's extra contractual law by denying his UIM claim.[8] The Colorado statute subjects "unreasonable" delays or denials of first party claims to penalties which include double coverage limits, attorney fees, and legal costs. Following a now familiar pattern, the statutory class the law aims to regulate is defined as "a person engaged in the business of insurance …" A separate portion of the statute defines the term "person" to include claims adjusters.

The Colorado Supreme Court heard arguments on the matter in early January 2022. The defendants argued that the statute itself is vague, given that it specifically refers to an "insurer's" delay or denial and not that of an individual. Perhaps more persuasively, they argue there is no evidence of a legislative intent to create such a "radical" result. That is, if the suit were allowed to proceed, claims representatives could be terrorized by the constant threat of lawsuit with each decision they make.

During oral arguments, Justice William H. Hood put the issue bluntly: "[W]ho in their right mind would wanna take this job of being a claims adjuster if you're staring down the barrel of this kind of liability on a regular basis?"[9] Though a strong practical argument, the ambiguous text of the law continues to leave much room for concern.

However the Colorado Supreme Court decides this issue, it shines light on a problem facing the insurance industry now and in the coming years. If the above examples are a guide, we can expect attempts by the plaintiff's bar in New Jersey to construe the IFCA as specifically allowing lawsuits to be directed at claims representatives. The nimbly crafted law certainly invites a multitude of interpretations.

Though concerning, a more reasonable reading of New Jersey's IFCA is that claimants are limited to filing lawsuits against their "automobile insurer," as explicitly stated in the law. Further, it would be difficult to imagine a legislative intent of exposing insurance representatives to repeated personal liability through each decision they make on a daily basis. While it is likely that New Jersey courts will follow Washington's lead on this issue, the next several years are sure to test the boundaries and processes of all who transact business within New Jersey.

In addition to the potential downstream effect of individual liability, the IFCA and its ilk carry a more-obvious potential for hesitancy by claims handlers. Representatives must now make claims decisions set against the undefined standard of "unreasonable delay or denial." As we have seen, the IFCA does not discuss "bad faith." Therefore we cannot assume that those standards will be found applicable. Claims handlers may decide to simply issue payments rather than question dubious claims. This could result in fewer investigation referrals and an increase in undiscovered fraud.

This trend is not limited to states with statutorily enforced bad faith.

In January 2022, an Oregon appeals court determined that a violation of the terms of an insurance contract could expose an insurer to a claim of negligence per se.[10] That is, an insurer that violates a statute is automatically considered to have breached its duty of care and is therefore negligent as a matter of law. The facts of this case are instructive.

Federal Insurance contracted to provide life insurance benefits of $3,000 to be paid in the event of Troy Moody's death. He was accidentally shot and killed while on a camping trip. The insurer asserted an exclusion for accidents resulting from the insured being under the influence. The carrier relied on a sheriff's toxicology report indicating that Mr. Moody had tested positive for marijuana. Not surprisingly, plaintiff's position is that Mr. Moody died solely because of the gun shot; the presence of marijuana in his system was not to blame. In addition to the policy claim, they argue that his widow should be compensated for the insurer's negligence per se by inflicting emotional distress with the unfounded denial. For this, they seek an additional $47,000 in excess of the policy limits.

The appellate panel determined that a negligence per se claim can be asserted against an insurance carrier. The court reasoned that insurance policies do not, "merely provide for the payment of funds in case of loss; they also provide the policyholder peace of mind."

The *Moody* decision is yet one more example of liability being interpreted well in excess of the contracted policy limits. A minimal policy with $3,000 limits is now susceptible to $50,000 in exposure. By all appearances, the issue could have easily been avoided. The facts of the case should stand as a stark reminder of how training on "good-faith" claims handling practices continues to be critical.

The plaintiffs bar will argue that the unlimited potential of Oregon's negligence per se standard and the treble damages element of New Jersey's IFCA are necessary. They make bad actors pay for their improper behavior and discourage others from doing the same.

Risk of false claims grows

An unintended consequence of such excessive penalties, however, is a much greater risk of fraudulent claims. As the saying goes, "when one door closes, another opens." The logic is simple. With a lower bar to entry and a greater chance of a "windfall" in damages, plaintiffs will be encouraged to pursue questionable claims at much higher frequency.

This concept is more than mere speculation. A 2008 meta-analysis by the National Association of Mutual Insurance Companies reviewed data showing "fraud suspicion indicators."[11] The indicators included: prevalence of alleged sprain injuries; treatment with chiropractors; and lack of a police report or visible injuries at the scene of an accident.

The study found that UM claims in states that allow tort actions for insurer bad faith are significantly more likely to contain characteristics associated with claims fraud. Even more alarming is the study's finding that insurers in those bad-faith states are not more aggress-

ive in investigating claims or in disallowing part of the claimed costs.

This analysis is in line with a Northwest Insurance Council determination that there was a 9.3-percent spike in "questionable claims" following Washington's enactment of its IFCA.[12] The state likewise saw a rise of $200 million in insurance claims during the three-year period following its passage. With an influx of such claims and the potential for personal liability, claims representatives may feel compelled to honor claims that were previously sent to the insurer SIU department.

Where does this all lead? In 2001, New Jersey's largest auto insurer at the time, State Farm, faced significant financial challenges due to a regulatory change that reduced premiums by 15 percent in the state. The insurance industry was assured that the law would be accompanied with additional regulatory revisions to reduce their costs. As state officials were perceived to be "dragging their feet" on the reforms, State Farm felt that it could no longer provide a financially viable business in the state. In response, it announced its intention to shutter its auto line and completely withdraw from doing business in New Jersey.[13]

This example shows the fragility of insurance markets. When large, well-regarded companies are forced out of a state, it is the consumer who pays the ultimate price with less desirable carriers, fewer options and higher premiums. These are the same consumers that the laws are supposedly meant to protect.

Taken together, these laws place a significant financial burden on insurance carriers and their claims representatives. How should insurer's plan for these changes and what steps can be taken to alleviate the likely challenges ahead?

Insurers must act

Forecasting the future is anything but certain. Waking up in this new era can be challenging, especially with a workforce that is greatly changed. However, one thing is certain: These laws are now in place, and the insurance industry at large must adapt to protect itself and its employees.

Perhaps the simplest thing to be done is get back to meaningful training of staff so the organization and its personnel are ready to be questioned about their practices and claim decisions. The pandemic has lulled an active fraud-fighting community into a state of virtual "do's and don'ts," instead of more robust educational programs designed to enhance an adjuster's knowledge base. Training your people properly will be integral to avoiding bad faith in New Jersey and other states as the landscape continues to shift.

Likewise, it is advisable to stop and take inventory of the current process and make sure insurers are ready to be challenged accordingly. Old or outdated claims practices likely fail to account for the recent changes in the law as to bad faith. The recent enactment of these new laws is a perfect time to reset best practices and communicate internally with all stakeholders to ensure risk is minimalized.

Being conscious of how these new laws can potentially impact an insurance company's brand is important. While nothing is certain, the next several years in bad-faith litigation are sure to be filled with first impressions.

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