

Chapter 1

Introduction

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§1:01 Introduction to the Law of Insurer Bad Faith in Pennsylvania

Pennsylvania has long recognized a policyholder’s right to bring a bad faith claim against an insurance company that fails to fulfill its duties of defense and/or indemnity under a liability insurance policy. However, prior to 1990, except in very rare cases, Pennsylvania courts did not allow a policyholder to assert a bad faith cause of action against an insurer in a first party claim.

In 1990, as part of comprehensive motor vehicle insurance legislation, the Pennsylvania General Assembly enacted a “bad faith statute,” codified at 42 Pa. C.S.A. §8371. That statute provides as follows:

In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:

- (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus three percent.
- (2) Award punitive damages against the insurer.
- (3) Assess court costs and attorney fees against the insurer.¹

Enactment of this statute dramatically altered the Pennsylvania landscape in insurance claims litigation. This book covers the developments in Pennsylvania's law of bad faith before and after the enactment of §8371. This introductory chapter is designed to provide the reader with a synopsis of the chapters that follow.

§1:02 Bad Faith in Pennsylvania and Other Jurisdictions

In the 1970s, starting first in California and then rapidly spreading elsewhere, courts across the nation began to allow policyholders to sue insurance companies directly for bad faith, permitting awards of extra-contractual damages, such as attorneys' fees and punitive damages.² Although a comprehensive review of the law of bad faith in all jurisdictions is beyond the scope of this book, Chapter 2, titled "Historical Development of Bad Faith," traces the development of the theory of insurer bad faith in other jurisdictions, which provided the backdrop for Pennsylvania's enactment in 1990 of 42 Pa. C.S.A. §8371, its statutory bad faith remedy. Chapter 2 also discusses the development of bad faith in Pennsylvania prior to 1990, including common law bad faith under liability policies and other remedies applicable to insurers.³

§1:03 Common Law Bad Faith in Pennsylvania

The concept of insurer bad faith in Pennsylvania arose within the court-created common law. This right of redress had its genesis in so-called "third party" claims, i.e., those claims which alleged misconduct in the way an insurer handled a liability claim

¹ 42 Pa.C.S.A. §8371.

² See §§2:04 and 2:05.

³ See §§2:06, 2:07 and 2:09.

brought against the insured by a third party. These claims typically involved a trial verdict in excess of the insured's liability policy limits, and a claim that the insurer unreasonably failed to settle the claim within those limits beforehand. Since the 1950s, the appellate courts in Pennsylvania have held that consequential damages may be awarded where an insurer exposes its policyholder to harm by breaching its implied contractual duty of good faith and fair dealing in the handling of a claim or lawsuit against the policyholder. This duty arises from the fact that under the liability policy the insurer controls the litigation against its insured, and thus is obligated to discharge its duties in a reasonable fashion.⁴ Chapter 3 of this book, "Common Law Bad Faith in Pennsylvania," discusses Pennsylvania common law dealing with bad faith in the context of the third party claim, and its interplay with the statutory cause of action enacted in 1990.

§1:04 Issues Arising Under Pennsylvania's Bad Faith Statute

The initial years after the enactment of any significant legislation are usually occupied by court challenges to the constitutionality of the statute and other court struggles over the interpretation of the statute's terms. So it was with §8371, Pennsylvania's so-called "bad faith statute," in the early 1990s. The task faced by those early courts, both state and federal, was particularly daunting with respect to §8371, because the General Assembly had provided virtually no legislative history or other evidence of legislative intent in connection with the law's passage.

Section 8371 allows for extra-contractual damages if "an insurer" acts in bad faith "toward the insured." The language of the statute is straightforward, seeming to suggest that only a policyholder is entitled to bring an action under §8371. Pennsylvania courts addressing this issue, however, have not restricted such actions merely to the policyholder, but have allowed others who may be deemed an insured to assert causes of action for bad faith.⁵ As to the party on the receiving end of a statutory bad faith action, the

⁴ See §§3:02, 3:03 and 3:04.

⁵ See §§4:02 and 4:03.

courts have generally limited §8371 actions to insurance companies.⁶ These issues are discussed in Chapter 4, titled “Parties to a Bad Faith Action Under Section 8371.”

Most courts have held that §8371 created a separate, independent cause of action, i.e., the right to recover damages for an insurance company’s bad faith action.⁷ Arguments which had been advanced by insurers to limit §8371—suggestions, for example, that it was an appendage to a breach of contract action providing only an additional remedy—have been generally rejected by the courts.⁸ Despite the acknowledged “independence” of §8371, courts have struggled to define the required relationship, if any, between a bad faith action and a breach of contract action, a task made difficult by the lack of evidence of the General Assembly’s intent in the passage of §8371.⁹ These issues are discussed in Chapter 5, “The Nature and Scope of an Action Under §8371.”

What type of conduct is covered under the bad faith statute? The statute itself makes reference only to actions “arising under an insurance policy.” It has been consistently held that §8371 applies to bad faith toward an individual insured, and not to an insurer’s general business practices.¹⁰ All courts agree that an insured can maintain an action for bad faith if the insurer wrongfully denies benefits under a policy. It has been held that an action for bad faith may not be based upon acts of the insurer which preceded the formation of a policy.¹¹ Some decisions suggested that the right to bring a bad faith action is limited to conduct of an insurer arising out of claims handling or benefit denials.¹² Other courts, however, have construed Pennsylvania’s bad faith statute more broadly.¹³ These issues are also addressed in Chapter 5.

The burden of proving bad faith is on the policyholder.¹⁴ Bad faith is something more than negligence or mere bad judgment

⁶ See §§4:07 and 4:08.

⁷ *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228 (Pa. Super. 1994). See §5:02.

⁸ *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228 (Pa. Super. 1994). See §5:02.

⁹ See §§ 5:04, 5:04(a) through (d).

¹⁰ See §5:05(a).

¹¹ See §5:05(b).

¹² See §5:05(c).

¹³ See §5:05(d).

¹⁴ See §7:07.

on the part of an insurer.¹⁵ Because §8371 does not provide a specific definition of bad faith, however, the courts initially struggled to arrive at a workable definition, and the Pennsylvania Supreme Court did not address the issue until 2017.¹⁶ These decisions are covered in Chapter 6, “Defining Bad Faith Under Section 8371.” In cases involving claim denials, it has been held that in order to recover under a claim of bad faith under §8371, the policyholder must show that the insurer (1) did not have a reasonable basis for denying benefits under the policy, and (2) knew or recklessly disregarded its lack of a reasonable basis in denying the claim.¹⁷

Procedural issues that have arisen since the enactment of §8371 are discussed in Chapter 7, titled “Procedural Issues in Bad Faith Actions.” One important subject—what must be pled in a complaint to sufficiently state a claim for bad faith—is discussed in this chapter.¹⁸ Another subject of significance to counsel for both policyholders and carriers concerns whether a judge or a jury is empowered to decide the issue of bad faith and, perhaps more importantly, award punitive damages.¹⁹

Common law bad faith claims are traditionally determined by a jury, if demanded. With respect to §8371 claims, however, there is a split between state and federal courts. Federal courts have held that, under the Seventh Amendment to the U.S. Constitution, a jury may decide the issues of bad faith and punitive damages under §8371.²⁰ However, Pennsylvania's Supreme Court has held that, in a state court trial, the judge, not the jury, determines bad faith and punitive damages.²¹

Courts have also addressed the applicable burden of proof in bad faith actions. The cases have been unanimous that the “clear and convincing” standard applies.²² Another issue concerns the

¹⁵ *Polselli v. Nationwide Mut. Fire Ins. Co.*, 23 F.3d 747 (3d Cir. 1994).

¹⁶ *See Rancosky v. Wash. Nat'l Ins. Co.*, 2017 Pa. LEXIS 2286 (Pa. Sept. 28, 2017).

¹⁷ *Rancosky v. Wash. Nat'l Ins. Co.*, 2017 Pa. LEXIS 2286 (Pa. Sept. 28, 2017); *Terletsky v. Prudential Prop. & Cas. Ins. Co.*, 649 A.2d 680, 689-90 (Pa. Super. 1994); *see* §6:02, §§6:02(a) and (b).

¹⁸ *See* §§7:01-7:03.

¹⁹ *See* §§ 7:02-7:06.

²⁰ *See* §7:04.

²¹ *See* §7:03.

²² *See* §7:07.

applicable statute of limitations for a bad faith action, at common law and under §8371. While arguments had been presented in favor of a two-year, four-year or six-year limitation period, the Pennsylvania Supreme Court ruled in 2007 that the limitation period for a §8371 claim is two years.²³ For a common law bad faith claim, which is based on contract, the prevailing view is that the limitation period is four years.²⁴ Other procedural matters include whether the bad faith claim should be brought in federal or state court; the role of filing preliminary objections, motions to dismiss, and motions for summary judgment in a bad faith case; and whether severance of claims and/or bifurcation of the issues at trial is permissible, all of which are discussed in Chapter 7.²⁵

Numerous court decisions have addressed how the policyholder can go about proving bad faith under §8371 at trial. Pennsylvania's Unfair Insurance Practices Act (UIPA)²⁶ and the related Unfair Claim Settlement Practices (UCSP) regulations²⁷ are often cited as providing appropriate guidelines for good faith insurance practices, but not all courts agree to their applicability.²⁸ Policyholders have also attempted to establish bad faith by proving that an insurer deviated from its own internal directives and/or claims handling procedures.²⁹ Cases discussing this issue appear in Chapter 8, "Proving Bad Faith." Also discussed in that chapter is the use of "claims handling experts." In order to facilitate the presentation of evidence before a jury, counsel in bad faith cases often seek to utilize the expertise of active or retired claims professionals, attorneys, or other persons familiar with insurance claims and litigation. As will be discussed in Chapter 8, the use of such experts and the scope of potential expert testimony is not without controversy.³⁰

²³ *Ash v. Conti'l Ins. Co.*, 932 A.2d 877 (Pa. 2007); see §7:09.

²⁴ See §7:10.

²⁵ See §§7:01-7:03; 7:14-7:22(c).

²⁶ 40 Pa. Stat. Ann. §1171.1-15 (1999).

²⁷ See 31 Pa. Code §146.1, et seq.

²⁸ See §§8:02-8:04.

²⁹ See §8:05.

³⁰ See §§8:06 and 8:07.

§1:05 Court Decisions Concerning What May Be, and What is Not, Bad Faith

Since the enactment of § 8371 in 1990, inclusion of a bad faith count in breach of contract complaints against insurers has become commonplace. This has resulted in many court decisions concerning the subject of what is, or is not, bad faith.

The reported decisions cover a wide array of potential bad faith conduct on the part of insurers, and are discussed in Chapter 9, “Examples Where Courts Have Found Bad Faith May Exist.” Courts have held that an excessive and unreasonable delay in the handling of claims may be sufficient to constitute bad faith.³¹ Misrepresenting facts or policy provisions may also constitute bad faith.³² Inadequate investigation of a claim, or inadequately researching the applicable law, can support a finding of bad faith,³³ as can making an unreasonable interpretation of a policy provision,³⁴ or unreasonably relying upon outside experts.³⁵

Refusing to defend an insured in a third party case may constitute bad faith, in the opinion of the courts, where the insurer lacked a reasonable basis for taking the position.³⁶ The handling of Uninsured Motorist and Underinsured Motorist claims has spawned many claims of bad faith.³⁷

A fertile area of bad faith litigation concerns an insurer’s failure to make a reasonable offer of settlement, which can arise in either the first or third party scenario. So-called “low balling” or refusing to make a settlement offer has been held to constitute bad faith.³⁸ Conduct by an insurer that might be considered threatening, if made with the intent to force an unfair settlement with the policyholder, might also constitute bad faith.³⁹ A few cases have arisen dealing with an insurer’s conduct, and that of its attorneys, in connection with litigation conduct. While alleged abuses in

^{31.} See §§9:02 and 9:03.

^{32.} See §§9:14 and 9:15.

^{33.} See §§9:04 and 9:05.

^{34.} See §§9:08 and 9:09.

^{35.} See §§9:06 and 9:07.

^{36.} See §§9:16 and 9:17.

^{37.} See §§9:10-9:13.

^{38.} See §§9:12 and 9:13; *compare* §§10:18 and 10:19.

^{39.} See §§9:18 and 9:19.

discovery do not support a bad faith claim,⁴⁰ courts have held that the acts of an insurer after litigation has commenced, or even in its decision to institute litigation, can, under some circumstances, constitute bad faith.⁴¹

Of course, policyholders are not always successful in proving that bad faith occurred. Under §8371, a finding of bad faith is premised upon an insurance company taking an unreasonable position with respect to the contractual rights of its policyholder. It follows that where the insurer takes a reasonable position in light of the facts of a particular claim, the applicable case law, or the applicable policy language, then such conduct does not constitute bad faith under §8371. Court opinions rejecting a policyholder's allegations of bad faith are found in Chapter 10, "Examples Where Bad Faith Has Been Found Not to Exist."

Where an insurance company correctly applies a particular policy provision, the policyholder's bad faith claim is usually denied.⁴² Even where an insurer's interpretation of a policy provision is found by a court to have been incorrect, if the insurer's interpretation was reasonable, virtually every court holds that there can be no bad faith.⁴³ Where an insurer reasonably interprets applicable legal precedent in arriving at a coverage determination, the courts generally find that the company did not act in bad faith.⁴⁴ And where an insurer's claims process and claims determination is reasonably based, a bad faith cause of action will not lie.⁴⁵

Where the court finds that an insurance company's delay in the handling of a claim, while perhaps regrettable, was not unreasonable, there is no bad faith.⁴⁶ The reasonable handling of a policyholder's claim under Uninsured Motorist or Underinsured Motorist coverages does not constitute bad faith.⁴⁷ When an insurer reasonably retains and relies upon one or more independent experts during the claims

^{40.} See *O'Donnell v. Allstate Ins. Co.*, 734 A.2d 901 (Pa. Super. 1999).

^{41.} See §§9:20 and 9:21(a) and (b).

^{42.} See §§10:02, 10:02(a) and 10:03(a)-(c).

^{43.} See §§10:04 and 10:05(a)-(c).

^{44.} See §§10:08 and 10:09.

^{45.} See §§10:06 and 10:07(a)-(d).

^{46.} See §§10:12 and 10:13.

^{47.} See §§10:16 and 10:17.

process, courts are reluctant to find bad faith under §8371.⁴⁸ Where the insurer’s investigation produces evidence of misrepresentations by its insureds, or possible fraudulent conduct on the part of the insureds, the court decisions are fairly consistent in dismissing the policyholder’s claims of bad faith.⁴⁹

With first party claims, where the insurance company takes a reasonable position regarding settlement of the policyholder’s claim, the insurer is generally found to have acted in good faith.⁵⁰ An insurer is usually not obligated to make a partial payment of a claim where the amount of benefits due is disputed.⁵¹ Finally, the conduct of an insurer and its counsel in deciding to file litigation, or in defending litigation, against its insured—including the propounding of discovery—as a general rule does not constitute bad faith under §8371.⁵²

§1:06 Damages Recoverable in a Bad Faith Action

Pennsylvania’s bad faith statute specifically allows for imposition of an award of attorneys’ fees, costs and interest where an insurer is found to have acted in bad faith, as discussed in Chapter 11, “Damages Recoverable: Attorneys’ Fees, Costs and Interest.” State and federal courts that have addressed this provision have held that it is for the trial judge, and not a jury, to determine the amount of attorneys’ fees, costs and interest to be awarded.⁵³ In addition, because §8371 provides that a court “may” award interest and assess court costs and attorneys’ fees, the courts are in agreement that such awards are discretionary, and not mandatory.⁵⁴ Any award for attorneys’ fees must be reasonable.⁵⁵

Section 8371 makes no allowance for recovery of any form of consequential or compensatory damages. In traditional third party common law bad faith cases, the measure of damages has

^{48.} See §§10:10 and 10:11.
^{49.} See §§10:14 and 10:15. See also Chapter 16, “Reverse Bad Faith.”
^{50.} See §§10:18 and 10:19.
^{51.} See §§10:18 and 10:19.
^{52.} See §§10:20 and 10:21(a) and (b).
^{53.} See §11:01-§11:03.
^{54.} See §§11:01-11:02
^{55.} See §11:02.

been the amount of an excess verdict over and above the policy's liability limits.⁵⁶ However, the Pennsylvania Supreme Court in 2001 ruled that in a third party bad faith action for failure to settle a liability claim within policy limits, an insurer may become liable for compensatory damages that are known or reasonably foreseeable above and beyond any excess verdict amount.⁵⁷ Whether appropriate or not, this reasoning has begun a drift toward cases involving *first* party bad faith claims. These interesting issues are addressed in Chapter 12, "Damages Recoverable: Compensatory Damages."

Lastly, §8371 provides for an award of punitive damages against an insurer found to have acted in bad faith. Punitive damages under §8371 pose the greatest risk to an insurer in a bad faith case. Pennsylvania allows the imposition of punitive damages in civil cases "to punish a tortfeasor for outrageous conduct and to deter him or others from similar conduct."⁵⁸ Punitive damages may be imposed where the plaintiff establishes that the conduct of the defendant is "outrageous," "malicious," "wanton," "reckless," "willful" or "oppressive."⁵⁹ Whether the imposition of punitive damages requires more than just a finding of bad faith has received attention in Pennsylvania and elsewhere.⁶⁰ Importantly, the U.S. Constitution and Pennsylvania law impose limits on punitive damages awards that are excessive or "shock the conscience" of the court.⁶¹ Cases discussing punitive damages issues are included in Chapter 13, titled "Damages Recoverable: Punitive Damages."

§1:07 Discovery in Bad Faith Litigation

Because of the high stakes in bad faith litigation, discovery battles occur quite often. Invoking the general liberality accorded by courts in interpreting the discovery rules, policyholders in bad faith

⁵⁶. See *Cowden v. Aetna Cas. & Sur. Co.*, 134 A.2d 223 (Pa. 1957) and §3:02; see generally Chapter 3.

⁵⁷. *Birth Ctr. v. St. Paul Cos.*, 787 A.2d 376 (Pa. 2001).

⁵⁸. *Kirkbride v. Lisbon Contractors, Inc.*, 555 A.2d 800, 803 (Pa. 1989); see also *Chambers v. Montgomery*, 192 A.2d 355, 358 (Pa. 1963).

⁵⁹. See §§13:02 and 13:04.

⁶⁰. See §§13:03 and 13:04.

⁶¹. See §§13:02, 13:03, 13:05 and 13:06.

litigation tend to be expansive in their discovery requests. Materials typically requested include the insurer's claim file,⁶² company claims manuals and other educational materials,⁶³ underwriting policies and guidelines,⁶⁴ information pertaining to other claims, insurance policies and/or lawsuits,⁶⁵ materials prepared by or for counsel,⁶⁶ information pertaining to reserves,⁶⁷ compensation paid to employees or agents,⁶⁸ and corporate financial information.⁶⁹ The extensive case law discussing the discovery of this type of information appears in Chapter 14, "Discovery in Bad Faith Litigation."

§1:08 Additional Bad Faith Issues

Much of the law of bad faith in Pennsylvania has been developed in disputes arising under policies of motor vehicle insurance. Issues particular to first party claims under motor vehicle policies are discussed in Chapter 15, titled "Application of Bad Faith to Medical and Wage Loss Claims Under the Motor Vehicle Financial Responsibility Law."

The interesting topic of "Reverse Bad Faith" is briefly discussed in Chapter 16. Some jurisdictions have recognized the doctrine of "reverse bad faith," in which an insurer alleges that the insured engaged in bad faith conduct that resulted in losses to the insurer. It has been said that the doctrine of reverse bad faith "creates an independent tort that allows an insurer to seek affirmative relief for an insured's breach of the duty of good faith and fair dealing."⁷⁰ Although Pennsylvania's bad faith statute is silent with respect to potential bad faith conduct on the part of the insured, several insurers have asserted "reverse bad faith" as a defense to a bad faith claim or as a counterclaim. As the jurisprudence governing §8371 developed, it turned out that only a very few Pennsylvania

⁶² See §§14:02 and 14:03.

⁶³ See §§14:06 and 14:07.

⁶⁴ See §§14:08 and 14:09.

⁶⁵ See §§14:10 and 14:11.

⁶⁶ See §§14:04 and 14:05.

⁶⁷ See §§14:12, 14:13 and 14:14.

⁶⁸ See §§14:17 and 14:18.

⁶⁹ See §§14:17 and 14:18.

⁷⁰ *First Bank of Turley v. Fid. & Deposit Ins. Co. of Md.*, 928 P.2d 298, 307 (Okla. 1996).

courts addressed the subject of reverse bad faith, rendering its viability as a separate action or defense uncertain.

Allegations of bad faith may arise within the context of the federal Employee Retirement Income Security Act (ERISA),⁷¹ the comprehensive federal scheme designed to protect pension plan participants and to ensure receipt of contractually defined benefits.⁷² Numerous types of insurance policies are issued as part of employee benefit plans. The Third Circuit Court of Appeals has conclusively determined that ERISA preempts bad faith claims where the disputed benefits derive from an employer-sponsored employee welfare benefit plan.⁷³ Cases discussing ERISA preemption appear in Chapter 17, “Additional Issues Under the Bad Faith Statute.” There are other federal and state statutes that have been held to preempt a bad faith claim, which are also discussed in Chapter 17. One such statute is Pennsylvania’s Workers’ Compensation Act. Courts have been uniformly cautious in permitting common law litigation, such as a bad faith claim, in the context of a work-related injury.⁷⁴

Lastly, Chapter 18 is titled, “The Unfair Trade Practices and Consumer Protection Law and Insurer Bad Faith.” Some complaints that include a bad faith claim under §8371 also include a claim under the UTPCPL, so there has begun to emerge specific jurisprudence addressing the UTPCPL in relation to the law of insurance bad faith. These issues are discussed in Chapter 18.

⁷¹ 29 U.S.C. §1001, et seq.

⁷² See *Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. 101 (1989).

⁷³ See §§17:01-17:04.

⁷⁴ See §§17:05 and 17:06.