

What Is Insurance Bad Faith

An insurer acts in bad faith when it unreasonably denies a legitimate claim. Though the concept is easy to understand, its application is not. What constitutes unreasonable conduct to you or me might not to someone else—especially an insurance defense attorney.

Insurers make the same arguments, time and time again, to defeat bad faith claims. The first is “mistake.” A very nice sounding insurance company attorney will say something like this: “We all make mistakes, and while it may have been a mistake to deny this claim, we certainly bore no ill will toward our insured.” By admitting that it is not perfect, the insurer attempts to take advantage of the juror (or judge) who believes that honest people—or insurers—can make mistakes. The hope is that the juror or judge will conclude that the insurer’s conduct was wrong, but was not unreasonable. Once this conclusion is reached, there can be no finding of bad faith.

The second common argument insurers make is the claim there was a “genuine dispute.” The insurer will say: “Look, this claim could have gone either way. There was a lot of information that supported paying this claim, and a lot of information that supported not paying this claim. In light of this genuine conflict, our actions were not unreasonable.” If the insurer succeeds with this argument, it will avoid liability for the bad faith claim denial.

WHY A FINDING OF BAD FAITH IS IMPORTANT: DAMAGES

To understand the importance of bad faith, it is useful to understand the difference between a “contract” claim and a “tort” claim. We all enter into contracts, whether it is with a contractor to fix our house, or for a cell phone, or even with a babysitter to babysit our children. An insurance contract is fundamentally the same kind of contract. The only difference is that an insurance policy gives peace of mind in exchange for the promise to pay money in the future. In any of these examples the party that does not hold up their end of the contract is in breach—thus the term “breach of contract.” The resolution, or damages, is the value of the contract. If a contractor does a bad job, the damages are the cost to get the job done properly. If an insurer breaches its contract of insurance, the damages are the value of the contract. So if your life insurance policy is for \$200,000 and the insurer denied the claim, the damages are \$200,000. If a disability policy calls for monthly benefits of \$5000, the damages are \$5000 times the number of months that benefits were due but were not paid. These are commonly referred to as “contract damages.”

The problem with contract damages is that it gives insurers no disincentive when they get caught denying legitimate claims. An insurer could deny many claims, safe in the knowledge that its worst-case scenario is paying the value of the contract—what it should have paid in the first place. This is where bad faith comes in.

The law recognizes that an insurance policy is a special kind of contract. It recognizes that all you really get with your policy is the promise to pay something in the future, if there is a covered loss. It also recognizes the disparity of power that exists between insurers and insureds. Insurers are usually

very large corporations with significant resources. Insureds do not have the same resources. One loss can be catastrophic. The insurance benefits may be the only means of survival. Without them people can be forced to sell their house, to file for bankruptcy, or at a minimum to significantly change their lifestyles.

An insurer who acts in bad faith is liable not only for the value of the insurance contract, but also for the emotional and financial distress it caused. In disability cases, if the jury finds that the insured is permanently disabled, it may award the entire value of the disability policy—as if the company paid all future benefits that would ever be due. Although some of these damages may be easy to measure, a judge or a jury is entitled to give its best estimate to the value of the emotional and financial distress caused by a bad faith claim denial.