

# **THE CASE FOR BAD FAITH DAMAGES**

## **IN ENGLISH INSURANCE LAW**

### **POINTS AGAINST THE PROPOSITION**

**BY**

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- Governments, rather than courts, are the proper entity to set public policy.
  
- The government has agencies in place to regulate the industry and can do it better and more efficiently than the court system.
  
- The experience in the United States has shown that introduction of bad faith concepts to the English system could cause appreciable change in the manner in which insurers operate, but not deter wrongful conduct; nor will it benefit the public. The adoption of bad faith law would be an exercise in policy making. What does the evidence show the effect of that policy in the United States has been?
  
- A study out of the University of Wisconsin looked at the effect of adopting third party bad-faith law nationwide with respect to auto liability policies. It concluded that empirical results show that the threat of bad faith claims cause insurers to settle ambiguous claims for amounts higher than their value. Thus, if the tort leads to higher payments, the tort is contributing to unnecessarily high insurance costs. The economic efficiency of the tort of bad faith is, therefore, highly suspect.
  
- A study out of the Rand Corporation Institute of Civil Justice concluded that the introduction of third party bad faith nationwide would likely lead to an increase in premiums on automobile policies 32-53%, translating into a 17-29% increase in total premiums on all liability policies. The tort, Rand concluded, would result in substantial increases in what insurers pay, and in turn translate into substantial increases in premiums paid by the population as a whole.

- A different study out of the Rand Corporation Institute of Civil Justice looked at the probable effects of allowance of bad faith tort law in first party health insurance claims, currently disallowed under U.S. federal law. The study concludes that:
  - All the empirical evidence suggests that the legal system's ability to deter wrongful conduct is weak.
  - The deterrent effect of new litigation would be imperfect: Decisions that cause injury may be deterred, but not all the time or in all the cases; at the same time, insurers will likely act defensively by paying unnecessary claims, leading to higher premiums.
  - There is considerable evidence that laypersons and lawyers do respond to the availability of new legal remedies by filing new claims, upwards of 53% of the time. Thus, the mere fact that the tort is available will inevitably lead to a potentially massive increase in litigation.
  - Decision makers generally over-react to the small possibility of having to pay large penalties for certain behavior. According to organizational behavior experts, decision makers often base decisions on worst-case scenarios, rather than on expected value calculations. So, a small number of lawsuits over wrongful denial or delay claims can lead to large overpayment even when such reactions are not justified by objective information.
  - The over-reaction is exacerbated when punitive or exemplary damages are available. Punitive damage exposure generally drives defendants to settle cases they would otherwise vigorously contest, and when they do settle to pay larger amounts they would otherwise pay. Defendant's willingness to pay a premium to settle such cases stimulates new litigation. Hence, the cost of punitive damages is observed both in the price to settle claims and in the frequency of litigation that ensues.
  - Ultimately, adoption of bad faith law in this setting would lead to potentially significant increases in both the cost of health insurance and in the cost of medical care itself.
  
- The witness' experience in representation of the insurance industry for 27 years bears out the statistics. It is not the public who benefit from bad faith claims, but rather a very small number of individual plaintiffs and the very large number of lawyers who specialize in handling such claims. From a public policy standpoint then, adoption of bad faith law will fail to affect the desired results.

- A final comment based on an example of a lawsuit in which I currently serve as an expert. The claim was a business interruption claim. Its value was contested, with the insurer's forensic accountant placing a potential value on the claim of \$1.7 million, although it could not reach any definite conclusions because it had not received the information from the insured needed to do so. The valuation was, therefore, tentative and preliminary. The insured's broker, AON, contacted the insurer and offered to settle the claim for \$1.4 million, which offer was accepted by the insurer. After the insured discovered the accountant's preliminary valuation, it sued the insurer for "bad faith", on the theory that the insurer was under a legal obligation to have rejected the insured's offer to settle because it was at an amount lower than the insurer's preliminary valuation suggested the claim might be worth.

I put it to you—Is this the kind of claim you wish to see clogging up your courts?

I would suggest not.