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New Jersey's Proposed Bad Faith Law Is Bad News For Insurers

The Current Level Playing Field

The New Jersey State Senate recently passed the New Jersey Insurance Fair Conduct Act (the "Act"). The bill is now being considered by the General Assembly. If the General Assembly passes the bill, most observers believe that Governor Phil Murphy will sign the measure into law.

Historically, the jurisprudence surrounding bad faith in New Jersey is fair toward insurers. Pursuant to the New Jersey Supreme Court's ruling in the well-known case of *Pickett v. Lloyd's*, as long as an insurer can demonstrate a fairly debatable basis for its claims position, a claim for bad faith cannot succeed. Additionally, absent bad faith, New Jersey law is clear that plaintiffs pursuing lawsuits arising from first-party claims cannot recover attorneys' fees. In the first party insurance context, punitive damages awards are also extremely rare.

In addition to reasonable legal standards relating to bad faith, New Jersey's Appellate Courts have also placed considerable procedural obstacles in the path of any insured seeking to prosecute a claim for first party bad faith. Such claims are routinely severed and stayed shortly after the complaint is filed, and usually settle as part of a global resolution with the underlying breach of contract claim. An insured who seeks to discover the contents of the insurer's claim file, while the breach of contract claim is pending, is generally unsuccessful. *See Procopio v. GEICO, 433 N.J. Super. 377 (App. Div. 2013).*

These sound and sensible rules have established New Jersey as a fair and objective terrain for insurers and insureds alike in bad faith suits that arise from first party claims. Current New Jersey law properly focuses on the foundational issues of determining whether coverage exists for such claims and, if coverage does exist, then determining recoverable damages. Currently, New Jersey courts only consider making awards in addition to policy benefits when an insurer's conduct lacks any debatable basis.

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Upending the Current System

If enacted, the Act threatens to dramatically alter New Jersey's stable and successful legal landscape. Under the Act, any unreasonable delay or denial of a claim for payment of benefits under an insurance policy would constitute a violation of the Act. Importantly, the Act does not provide any guidance on the definition of "unreasonable delay" or "unreasonable denial."

Much more problematic is that the Act defines any violation of the provisions of N.J.S.A. 17:29b-4 as a violation of the Act. The referenced law identifies certain claims handling practices as unfair practices, but only when the practices are committed "with such frequency as to indicate a general business practice . . . ." The unfair claim practices identified include, but are not limited to: (1) failing to adopt and implement reasonable standards for prompt investigation of claims; (2) failing to affirm or deny coverage of claims within a reasonable time after a proof of loss has been received; (3) requiring a proof of loss form be completed after a preliminary report has already been provided, which contains "substantially the same information;" and (4) failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or law for the denial of a claim or for the offer of compromise of a settlement. Additionally, the referenced law notes that other practices not specifically enumerated by the law can still be considered unfair claims settlement practices.

It is important to understand the original purpose of N.J.S.A. 17:29b-4. The purpose was to identify insurance companies that engaged in unfair claims settlement practices on a systematic basis. Once systematic abuses are identified, the Department of Banking & Insurance is empowered to take certain measures against insurance companies that engaged in prohibited practices on a habitual basis. Notably, the law did not provide a private cause of action for any insured. It also was not designed to punish an insurance company for claims handling on any single claim.

The Act radically alters New Jersey law. Under the Act, any violation of N.J.S.A. 17:29b-4 is a violation of the Act. The Act further states "in any action filed pursuant to this Act, the claimant shall not be required to prove that the insurers action were of such a frequency as to indicate a general business practice." As noted above, N.J.S.A. 17:29b-4 was enacted specifically for the purpose of punishing insurers who systematically engaged in unfair claims settlement practices. It was not designed to address singular or isolated failures in claims handling on a single claim. The Act completely reverses this arrangement.

Major Mandatory Penalties for Minor Violations

Under the Act, a first party insurer that requests a proof of loss after receipt of a public adjuster's estimate has arguably violated the Act by making a clearly innocuous request. Similarly, a denial letter on a first party claim, which cites all the applicable policy provisions but fails to elaborate on the application of those provisions to the claim at issue, is arguably in violation of the Act. Further, a claims representative that neglects to respond to a single communication from an insured or the insured's representative, or responds to that single letter in an untimely fashion, has arguably violated the Act.

These "violations" cause little to no damage to an insured. When a claims professional for an insurance company requests a proof of loss, neglects to respond to a single correspondence, is

delayed in responding to a single correspondence, or drafts a denial letter that fails to fully articulate the application of the insurance policy provisions to the facts of the insureds claim, the insured is not significantly harmed. Such circumstances can be remedied by requests for additional information or follow-up requests for a response to correspondence.

The Act fails to recognize the basic reality that insurance claims adjustment is a document intensive industry in which claims professionals may provide service on dozens of claims in a single day. Inevitably, minor mistakes and imperfections will occur. Instead, the Act elevates these minor mistakes into "violations."

When a violation occurs, the Act requires an award of damages. The awarding of damages is not left to the discretion of a judge or jury, but is mandatory. When a violation exists, a plaintiff is entitled to actual damages, attorneys' fees and treble damages.

Misguided Incentives

Current New Jersey bad faith jurisprudence is properly focused on the fundamental issues of whether or not coverage exists and how much is owed on an insurance claim. Under current New Jersey law, an insurance company is already incentivized to refrain from unreasonably denying claims. The Act strengthens those incentives by mandating that a successful insured who proves that the insurance company unreasonably denied the claim is entitled to actual damages, treble damages and attorneys' fees.

Unfortunately, the Act also disproportionately punishes insurers for insignificant claim handling errors. Instead of recognizing the inevitability of minor claims handling errors, the Act imposes extreme and mandatory penalties on insurance companies for these errors. Consequently, the Act creates an incentive for insureds to generate litigation over trivial claims handling errors. It is unlikely that such an outcome advances any legitimate public interest of insurers or policyholders in the State of New Jersey.

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