IN THE SUPREME COURT OF PENNSYLVANIA

No. 28 WAP 2016

MATTHEW RANCOSKY, ADMINISTRATOR DBN OF THE ESTATE OF LEANN RANCOSKY AND MATTHEW RANCOSKY, EXECUTOR OF THE ESTATE OF MARTIN L. RANCOSKY,
Appellee,

v.

WASHINGTON NATIONAL INSURANCE COMPANY, AS SUCCESSOR BY MERGER TO CONSECO HEALTH INSURANCE COMPANY, FORMERLY KNOWN AS CAPITAL AMERICAN LIFE INSURANCE COMPANY,
Appellant.

AMICUS CURIAE BRIEF OF UNITED POLICYHOLDERS IN SUPPORT OF APPELLEE

Appeal from the Judgment of the Superior Court entered on December 16, 2015, at No. 1282 WDA 2014 affirming in part and vacating in part the Judgment entered on August 1, 2014, of the Court of Common Pleas of Washington County, Civil Division at No. 2008-11797

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STATEMENT OF INTEREST OF AMICUS CURIAE

United Policyholders is a not-for-profit educational organization with tax exempt status under § 501(c)(3) of the Internal Revenue Code. The mission of United Policyholders is to educate the public on insurance issues and consumer rights related thereto, and to assist policyholders in securing prompt, fair, insurance settlements. United Policyholders provides educational materials, organizes meetings in disaster areas, provides speakers at community and government forums, and acts as a clearing house for information on insurance issues.

United Policyholders also provides assistance in large catastrophes. After a disastrous firestorm in 1991 that destroyed over three thousand structures in Oakland and Berkeley Hills, California, United Policyholders sponsored meetings, workshops, and seminars for the victims, and worked with local officials, insurers and relief agencies to facilitate claim settlements. United Policyholders has provided the same services in Florida for victims of Hurricane Andrew, in Texas for victims of the Northridge Earthquake, and in Northern California for victims of a wildfire.

United Policyholders also files amicus curiae briefs in insurance coverage cases of public importance. Filing amicus curiae briefs is an important part of United Policyholders' activities. The amicus curiae briefs filed by United Policyholders have been accepted by courts throughout the country. *See, e.g.,*

Humana, Inc. v. Forsyth, 119 S. Ct. 710, 719, 142 L. Ed. 2d 753 (1999) (citing to Brief for United Policyholders as Amicus Curiae); *see also Western Alliance Ins. Co. v. Gill*, 686 N.E. 2d 997 (Mass. 1997).

United Policyholders' activities are limited only by the organization's exclusive reliance on donated labor and contributions of services and funds. This brief has been prepared pro bono by counsel at law firms who have donated their time with no contributions from any other source.

United Policyholders has a vital interest in seeing that insurance companies comport with the duty of utmost good faith in representing the interests of their insureds. That duty flows from the contracts of insurance sold to policyholders. United Policyholders consequently has an interest in maintaining and advancing the jurisprudence of "bad faith" in Pennsylvania, which was intended to protect insureds from unlawful conduct by insurance companies.

SUMMARY OF ARGUMENT

Insurance companies have an inherent financial self-interest to delay payment on claims. The longer the delay, the more they stand to gain by investing the premiums they receive from policyholders. The insurance industry calls this tactic "playing the float."

In the decade prior to the enactment of the insurer bad faith statute in 1990, playing the float became extremely attractive. Interest rates reached historically high levels, exceeding 20% during that period. In the context of these historically high rates, the Pennsylvania legislature enacted Section 8371. The statute made playing the float far less attractive by authorizing courts to award interest at 3% above the prime rate. The statute also sought to discourage bad faith by authorizing an award of punitive damages and attorney's fees.

Although the Pennsylvania legislature did not define bad faith in the statute, the Superior Court of Pennsylvania adopted a two-part test for bad faith in *Terletsky v. Prudential Property and Cas. Ins. Co.*, 649 A.2d 680 (Pa. Super. Ct. 1994). That test does not require a policyholder to prove that the insurer acted with a "motive of self-interest or ill will." Over the past twenty-plus years, numerous state and federal courts have applied *Terletsky's* two-part test. None of those courts added "bad motive" as a third element of the test. On the contrary, those courts expressly rejected every attempt by insurers to impose such a

requirement on policyholders. The reasoning of those courts is consistent with the law of punitive damages in Pennsylvania, which likewise does not require proof of a bad motive.

Over the course of the past two decades, state and federal courts have applied the *Terletsky* test to a variety of acts (and failures to act) by insurers. Thus, while the two-part test articulated in *Terletsky* dealt only with an insurer's refusal to pay benefits, that test has been applied to conduct such as the improper investigation of a claim. This Court therefore should adopt a standard for insurer bad faith that applies to any action an insurer takes or fails to take after issuing a policy to its insured.

ARGUMENT

I. The Context and Purpose of Pennsylvania's Insurer Bad Faith Statute Are Relevant to Its Meaning

A. The Duty of Insurers to Act in Good Faith Conflicts with Their Inherent Financial Self-Interest

People buy insurance to secure peace of mind. Catchphrases like "you're in good hands with Allstate" and "like a good neighbor, State Farm is there" are engrained in our lexicon. Policyholders agree to incur a certain cost – in the form of a premium – in exchange for protection against an uncertain loss or liability. If and when an insured event occurs, policyholders expect the insurer to respond quickly and provide that bargained-for protection.

Insurance companies, however, have a natural, inherent self-interest to delay payment. Insurers invest the premiums received from selling insurance policies and earn profits on what is called "float" – that is, "[t]he time gap between the receipt of premiums and the payment of claims . . .." Doron Nissim, *Analysis and Valuation of Insurance Companies*, CENTER FOR EXCELLENCE IN ACCOUNTING AND SECURITY ANALYSIS, COLUMBIA BUSINESS SCHOOL (November 2010) p. 4, *available at* http://www.columbia.edu/~dn75/ Analysis%20and%20 Valuation%20of%20 Insurance%20Companies%20-%20Final.pdf. The time gap frequently is substantial, as where the insured losses are discovered many years after the event (such as in the asbestos context) and where the claim settlement process extends over multiple years. *Id.*

Warren Buffett, Berkshire Hathaway's Chairman and Chief Executive, has openly acknowledged the lucrative profits that his insurance companies earn on the float:

> Insurers receive premiums upfront and pay claims later . . . . This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit. . . .
>
> This . . . allows us to enjoy the use of free money – and, better yet, get *paid* for holding it . . . .

Berkshire Hathaway, Inc. *2009 Annual Report to Shareholders* p. 6, *available at* http://www.berkshirehathaway.com/2009ar/2009ar.pdf.

The float gives insurance companies a unique and powerful advantage over their policyholders:

> Unlike most other commercial actors fighting for supremacy in a world where possession is nine-tenths of the law, insurers always have the nine-tenths advantage: They hold the money. Consequently, insurers always get to "play the float" in any dispute. Even where the judicial system acts rapidly and efficiently to provide compensation to wronged policyholders, the carrier may find it made money by delaying payment of the claim. If its investments have been good, it may even have made enough to cover any prejudgment interest, costs, or consequential damage award, or counsel fees collected by the policyholder.

Eugene R. Anderson, Jordan S. Stanzler, Lorelie S. Masters, *Insurance Coverage Litigation* § 11.05 (2 ed. 1999) (*quoting* Jeffery W. Stempel, *Interpretation of Insurance Contracts: Law and Strategy for Insurers and Policyholders* § 19.3, at

466-67 (1994)) (footnotes omitted). The magnitude of the insurers' advantage, and their willingness to use that advantage against their policyholders, is daunting. According to the American Insurance Association, an insurance industry trade group, the insurance industry spends "(conservatively) $1 billion a year on litigation against its policyholders." *Id.*

Legal commentators have noted the conflict between the policyholder's need for prompt and fair payment of claims and the insurance company's inherent financial self-interest:

> Because of their superior financial strength, it may be cost-effective for insurance companies to refuse to pay legitimate claims. Many policyholders, even those with relatively significant resources, simply will give up and go away.
>
> Even if a policyholder sues its insurance company, the insurance company may calculate that it will profit by prolonging the dispute rather than paying the claim – even if it knows the claim is valid. The insurance company has the use of the premium and reserves throughout the course of any insurance coverage action, thus earning investment income, which may offset any eventual losses. Thus, unless an insurance company is faced with the prospect of damages well in excess of the policy limits, it will have no incentive to honor its obligations under the insurance policy . . . .

Id.

Because of these inherent economic realities, any act (or failure to act) by an insurer that delays or minimizes payments to the insured is conduct that, *ipso facto*,

promotes the self-interest of the insurance company. The Pennsylvania Legislature understood this simple fact when it adopted Section 8371.

B. Prior to the Enactment of Section 8371, Interest Rates Reached Historically High Levels

Playing the float became particularly attractive in the years before the adoption of Section 8371. The prior decade was marked by historically high interest rates. From 1980 to 1990, the prime rate of interest ranged from a high of 21.5% to a low of 7.5% and for the bulk of that decade was well above 10%. Board of Governors of the Federal Reserve System, *Average Majority Prime Rate Charged by Banks on Short-Term Loans to Business, Quoted on an Investment Basis, available at*: https://www.federalreserve.gov/datadownload/Download.aspx?rel=H15&series=6fa2b8138e0eafe0ad6cde24ba2307f5&from=01/01/1980&to=12/31/1990&lastObs=&filetype=csv&label=include&layout=seriescolumn. These economic conditions provided insurers with an even greater than usual financial self-interest to delay payment of claims to profit from the float. The slower insurers paid out claim dollars, the more they stood to gain in investment income.

The Pennsylvania Legislature would have been well aware of this tension between the justified expectations of Pennsylvania policyholders and the financial self-interests of insurance companies when it adopted Section 8371. One of the three special remedies the Legislature included in the bad faith statute – the award of interest at the prime rate plus 3% – was specifically designed to deter delay in

the payment of claims by placing the insurers' profits at risk. The Legislature knew that if an insurer delayed the payment of a claim and did not have a reasonable basis for that delay, that conduct – in and of itself – was a willful act in disregard of the insured's rights and thus "bad faith," because the Legislature had made clear in the Unfair Insurance Practices Act that insurers were obligated "to act promptly upon written or oral communications with respect to claims," to "implement reasonable standards for the prompt investigation of claims," and "to effectuate prompt, fair and equitable settlements of claims . . .." 40 P.S. § 1171.5(a)(10)(ii), (iii) and (vi).

II. The Superior Court Correctly Held that "Motive of Self-Interest or Ill Will" Is a Discretionary Consideration Rather than a Requisite Element of the Bad Faith Cause of Action

Section 8371 creates a private cause of action for insurer bad faith. The legislature neither defined "bad faith" nor specified the elements necessary to prove bad faith. Those responsibilities were left to the courts.

In 1994, the Superior Court established a two-part test for proving bad faith on the part of an insurer in *Terletsky v. Prudential Property and Cas. Ins. Co.*, 649 A.2d 680 (Pa. Super. Ct. 1994). The Superior Court held that an insured must show that: (1) the insurer did not have a reasonable basis for denying benefits under the policy; and (2) the insurer knew or recklessly disregarded its lack of reasonable basis in denying the claim. *Id.* at 688. That two-part test was not

created by the *Terletsky* court. In *D'Ambrosio v. Pennsylvania Nat. Mut. Ins. Co.*, 431 A.2d 966, 971 (Pa. 1981) (which the Superior Court cited in *Terletsky*), this Court expressly quoted a nearly identical two-part test adopted by the Supreme Court of Wisconsin in *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368, 376 (1978). This Court in *D'Ambrosio* also cited to *Bibeault v. Hanover Ins. Co.*, 417 A.2d 313 (R.I. 1980), a case where the Supreme Court of Rhode Island had adopted a similar two-part test, following the lead of the Wisconsin Supreme Court:

> To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. . . . **Implicit in that test is our conclusion that the knowledge of the lack of a reasonable basis may be inferred and imputed to an insurance company where there is a reckless . . . indifference to facts or to proofs submitted by the insured.**

Bibeault, 417 A.2d at 319 (emphasis added), quoting *Anderson*, 271 N.W.2d at 376-77. The Supreme Court of New Jersey has called this a "balanced approach" to proving insurer bad faith. *Pickett v. Lloyd's*, 621 A.2d 445, 473 (N.J. 1993).

The two-part test adopted in other jurisdictions, referenced by this Court in *D'Ambrosio* and then adopted by the Superior Court in *Terletsky*, has been consistently applied in Pennsylvania ever since. *See, e.g., Greene v. United Servs. Auto. Ass'n*, 936 A.2d 1178, 1188 (Pa. Super. Ct. 2007); *Condio v. Erie Ins. Exch.*,

899 A.2d 1136, 1143 (Pa. Super Ct. 2006); *Morrison v. Mountain Laurel Assur. Co.*, 748 A.2d 689, 691-92 (Pa. Super. Ct. 2000); and *MGA Ins. Co. v. Bakos*, 699 A.2d 751, 754 (Pa. Super. Ct. 1997); *see also* cases listed infra at n.1

A. A Motive of Self-Interest or Ill Will Is Not a Third Requisite Element for Proving Insurer Bad Faith Under Section 8371

In *Terletsky*, the Superior Court quoted the definition of bad faith in Black's Law Dictionary, which mentions "motive of self-interest or ill will." However, the Superior Court in *Terletsky* did not elevate that phrase to stand co-equal with the two-part test for proving bad faith. Since *Terletsky* was decided, state and federal courts applying Pennsylvania law have rejected all attempts to elevate the phrase "motive of self-interest or ill will" to an additional element required in order to prove bad faith.[1] In many cases, such as *Greene*, *Condio*, *Morrison*, and *MGA*

[1] *Jurinko v. Medical Protective Co.*, 305 F. App'x 13, 21 (3d Cir. 2008); *Paul v. State Farm Mutual Automobile Ins. Co.*, No. 14-1382, 2016 WL 5407734 at *30 (W.D. Pa. Sept. 9, 2016); *Lewis v. Atlantic States Ins. Co.*, No. 08-01040, 2014 WL 12595309 at *7 (W.D. Pa. Sept. 26, 2014); *Williamson v. Chubb Indem. Ins. Co.*, No. 11-6476, 2013 WL 6692570 at *4 (E.D. Pa. Dec. 19, 2013); *Schifino v. Geico General Ins. Co.*, No. 11-1094, 2013 WL 6533180 at *17 n.20 (W.D. Pa. Dec. 13, 2013); *Schmitt v. State Farm Ins. Co.*, No. 09-1517, 2011 WL 4368400 at *10 (W.D. Pa. Aug. 12, 2011); *MP III Holdings, Inc. v. Hartford Cas. Ins. Co.*, No. 08-4958, 2011 WL 2604736 at *17 (E.D. Pa. June 30, 2011); *Roppa v. Geico Indem. Co.*, No. 10-1428, 2010 WL 5600899 at *4 (W.D. Pa. Dec. 29, 2010); *Hampton v. Geico Ins. Co.*, 759 F. Supp. 2d 632 (W.D. Pa. 2010); *Smith v. Continental Cas. Co.*, No. 07-1214, 2008 WL 4462120 at *14 (M.D. Pa. Sept. 30, 2008); *Nordi v. Keystone Health Plan West Inc.*, 989 A.2d 376 (Pa. 2010); *Mohney v. American General Life Ins. Co.*, 116 A.3d 1123 (Pa. Super. Ct. 2015); *Sharp v. Travelers Personal Sec. Ins. Co.*, 36 Pa. D. & C. 5th 521 (Pa. Com. Pl.

cited above, the court quotes the Black's Law Dictionary definition of bad faith and then sets forth the two-prong *Terletsky* test to prove bad faith. As those courts recognized, the two prong test articulated in *Terletsky* is entirely consistent with the definition of bad faith in Black's Law Dictionary. In conformity with this long line of precedent, the Superior Court in the instant case correctly noted that "[a] 'motive of self-interest or ill will' may be considered in determining the second prong of the test for bad faith, *i.e.*, whether an insurer knowingly or recklessly disregarded its lack of a reasonable basis for denying a claim." *Rancosky v. Washington Nat. Ins. Co*., 130 A.3d 79, 94 (Pa. Super. Ct. 2015).

Twenty years ago, the Third Circuit directly addressed the insurers' argument that "a third element must be satisfied, to wit, that the insurer was motivated by an improper purpose such as ill will or self-interest." *Klinger v. State Farm Mut. Auto. Ins. Co.*, 115 F.3d 230, 233 (3d Cir. 1997). The *Klinger* court first observed that "State Farm's self-interest is the only plausible explanation for its delay." *Id.* The court then held that there is no third part to proving insurer bad faith under § 8371, concluding as follows: "In our prediction of how the Pennsylvania Supreme Court would measure bad faith claims, we will rely on the actual test that *Terletsky* applied and refrain from creating a third part based only on dictum quoted from *Black's Law Dictionary*." *Id.* at 234.

Mar. 7, 2014); *Webber v. Erie Ins. Exch.*, 34 Pa. D. & C. 5th 364 (Pa. Com. Pl. Nov. 14, 2013).

The Superior Court also tackled this issue head on in the case of *Greene v. United Services Auto. Ass'n*, 936 A.2d 1178 (Pa. Super. Ct. 2007). The Superior Court in *Greene* agreed with the Third Circuit's conclusion in *Klinger*:

> To the extent that *Klinger* holds that there is no "third element" for purposes of a bad faith claim, the reasoning of the court of appeals is consistent with a conclusion that considerations of "the motive or [sic] self-interest or ill will" are probative with respect to a refusal to pay being frivolous or unfounded. This court concludes that the "motive of self-interest or ill will" level of culpability is not a third element required for a finding of bad faith, but is probative of the second element identified in *Terletsky*, *i.e.*, "the insurer knew or recklessly disregarded its lack of reasonable basis in denying the claim." *Terletsky*, 649 A.2d at 688.

Greene, 936 A.2d at 1190 (quoting *Employers' Mutual Cas. Co. v. Loos*, 476 F. Supp. 2d 478, 490-91 (W.D. Pa. 2007)).

In light of this long, unbroken line of decisions dating back twenty years, the characterization of those decisions by the Appellant and its amici is stunningly and inexcusably false. Appellant Conseco Health Insurance Company ("Conseco") wrongly states that "until this case, the Superior Court had consistently articulated and applied the *Terletsky* standard as requiring a finding of an improper subjective motivation of improper self-interest or ill will." *See, e.g.*, Conseco Br. at 48. Conseco even has the temerity to cite *Greene* as supporting this proposition when, in fact, *Greene* does nothing of the kind. Likewise, Conseco's amici wrongly state that "'self-interest or ill will,' as a required prong of 'bad faith,' has been a

remarkably consistent mandate in the context of claims handling and insurance litigation over the years." Pennsylvania Defense Institute and Pennsylvania Association of Mutual Insurance Companies Amicus Br. at 13, 15. The amici cite no authority for this proposition, and for good reason. No court has ever added a third part to the *Terletksy* test.

B. Conseco and Its Amici Improperly Conflate the Definition of Bad Faith with the Elements Required to Prove Bad Faith

Conseco and its amici argue that "motive of self-interest or ill will" is an independent element of a claim for bad faith because that phrase appears in the Black's Law Dictionary definition of "bad faith." That argument fails for three reasons. First, the definition itself does not state that "motive of self-interest or ill will" is a separate and independent element of bad faith. Rather, the definition states that a bad faith claim is the "frivolous or unfounded refusal" of benefits and that "such conduct **imports** a dishonest purpose and means a breach of a known duty . . . through some motive of self-interest or ill will." (emphasis added). As the Third Circuit noted in the *Klinger* case, an insurer's "self-interest is the only plausible explanation" when it unreasonably delays or denies payment of a claim. 115 F.3d at 233. The definition of bad faith in Black's Law Dictionary is consistent with that understanding. The definition essentially says that whenever an insurance company makes a frivolous or unfounded refusal to provide benefits, that conduct itself imports that the insurance company is acting through a motive

of self-interest or ill will. Insurers stretch the dictionary definition too far by parsing out one phrase and elevating it to a necessary element of proof.

Second, courts elsewhere have generally declined to use definitions contained in Black's Law Dictionary to serve as the benchmark for establishing rights and liabilities, especially in the case of statutory provisions. *See, e.g.*, *Scott v. Equity Grp., Inc.*, 381 P.3d 660 (Nev. 2012)(Black's Law Dictionary definition of negligence is not synonymous with the elements of negligence); *Arriaga v. Mukasey*, 521 F.3d 219, 226 (2d Cir. 2008) (Black's Law Dictionary definition of stalking is different from the elements required to prove stalking); *FL Receivables Trust 2002-A v. Arizona Mills, L.L.C.*, 281 P.3d 1028, 1035 (Ariz. Ct. App. 2012) (declining to use Black's Law Dictionary to determine meaning of statutory term); *Kaheawa Wind Power, LLC v. City. of Maui*, 347 P.3d 632, 638 (Haw. Ct. App. 2014) (rejecting argument that the court should apply the Black's Law Dictionary definition of "improvement" to tax code).

Third, this Court recently rejected a similar reliance on a "pithy" restatement of the law in *Tincher v. Omega Flex, Inc.*, 104 A.3d 328 (Pa. 2014). In *Tincher*, the Court examined the elements of a cause of action in tort for "design defect." The Court declined a wholesale adoption of the approach outlined in the Restatement of Torts. In announcing its own test based on case law and policy considerations, the Court noted that the Restatement simply offers a "pithy

articulation of a principle of law which, in many cases, including novel or difficult ones, represents a starting template for members of the judiciary, whose duty is then to employ an educated, candid, and common-sense approach to ensure dispensation of justice to the citizenry." 104 A.3d at 415.

Like the definition of design defect in the Restatement, the definition of bad faith in Black's Law Dictionary is merely a "pithy articulation of a principle of law" that is nothing more than the "starting template for members of the judiciary." As noted above, the members of the judiciary in Pennsylvania have started with that dictionary definition and then "employ[ed] an educated, candid and common-sense approach" to conclude that "motive of self-interest or ill will" is not a third element of bad faith. The Court should not reverse this well-established and well-reasoned line of case law.

C. The Reliance by Conseco and Its Amici on this Court's Holding in *Toy* Is Misplaced

In arguing that "motive of self-interest or ill will" is a requisite element to proving insurer bad faith, Conseco and its amici rely heavily on this Court's holding in *Toy v. Metropolitan Life Ins. Co.*, 928 A.2d 186 (Pa. 2007). (Conseco Br. at 49). The reliance on *Toy* for that proposition is misplaced.

There is nothing in *Toy* to suggest that the "motive of self-interest or ill will" is a third, requisite element for proving insurer bad faith under § 8371. In fact, the Court in *Toy* makes no mention of the definition of bad faith or the "motive of

self-interest or ill will." The Court explicitly declined to take a position in *Toy* on the "standard of conduct" to be applied in determining whether an insurer is liable under § 8371. *Toy*, 928 A.2d at 200 n. 18. Significantly, in referencing the standard of conduct that the Superior Court has employed, this Court in *Toy* delineated the two-part *Terletsky* test: "Rather, the Superior Court . . . reiterated its view that the requisite elements of a bad faith claim are that the insurer refused to provide benefits and knew or recklessly disregarded that it lacked a reasonable basis for the refusal." *Id.* at 193.

By contrast, the opinion in *Toy* emphasized that the term "bad faith" embraces the full scope of the insurer's duties to its insureds. The Court observed that the insurer bad faith statute is concerned with:

> the duty of good faith and fair dealing in the parties' contract and the manner by which an insurer discharge[s] its obligations of defense and indemnification in the third-party claim context or its obligation to pay for a loss in the first-party claim context. . . . In other words, the term [bad faith] capture[s] those actions an insurer took when called upon to perform its contractual obligations of defense and indemnification or payment of a loss that failed to satisfy the duty of good faith and fair dealing implied in the parties' insurance contract.

928 A.2d at 199 (footnote omitted). This Court had previously determined that an insurer's payment of policy benefits, including amounts in excess of policy limits, will not insulate an insurer from a bad faith claim. *See Birth Center v. St. Paul Companies, Inc.*, 787 A.2d 376, 384-85 (Pa. 2001).

Accordingly, the opinions in *Toy* and *Birth Center* leave no doubt that insurer bad faith is not limited to the failure to pay benefits. As the Court explained in *Toy,* bad faith captures all of the actions that an insurer takes or fails to take "when called upon to perform its contractual obligations of defense and indemnification or payment of a loss that failed to satisfy the duty of good faith and fair dealing implied in the parties' insurance contract."

Consistent with this Court's observation in *Toy*, lower Pennsylvania courts and federal judges applying Pennsylvania law have generally succeeded in identifying the type of conduct that can constitute bad faith under Section 8371, whether that is an act on the part of the insurer or a failure to act, by applying *Terletsky's* two-part standard. Examples of lower court decisions applying Section 8371 broadly to the full scope of the insurer's duties of good faith include the following:

- *Grossi v. Travelers Personal Ins. Co.*, 79 A.3d 1141, 1153 (Pa. Super. 2013) (insurer must properly investigate claims and commits bad faith by blindly resisting claims);

- *Bonenberger v. Nationwide Mut. Ins. Co.*, 149 P.L.J. 144 (Pa. Com. Pl. 2000) (Allegheny Cty.), *aff'd*, 791 A.2d 378 (Pa. Super. 2002) (bad faith where insurer disregarded plaintiff's medical records, conducted no independent medical examination, and made no reasonable evaluation based on the facts of the plaintiff's injury);

- *Galko v. Harleysville Pennland Ins. Co.*, 71 Pa. D.&C. 4th 236, 239 (Pa. Com. Pl. 2005) (Lackawanna Cty.) (bad faith where insurer, after learning that its original reason for denying coverage

was not supported by the facts, delayed its decision to provide coverage for two years);

- *Rutkowski v. Allstate Ins. Co.*, 69 Pa. D.&C. 4th 10 (Pa. Com. Pl. 2004) (Lackawanna Cty.) (bad faith where insurer ignored findings of its own special investigative unit, ignored requests for information by insured, and withheld information or altered documents to manufacture a basis for its denial of coverage);

- *Corch Construction Co. v. Assurance Co. of America*, 64 Pa. D.&C. 4th 496 (Pa. Com. Pl. 2003) (Luzerne Cty.), *aff'd w/o opin.*, 881 A.2d 893 (Pa. Super. 2005) (bad faith where insurer ignored evidence helpful to coverage and failed to perform adequate investigation);

- *Hollock v. Erie Ins. Exchange*, 54 Pa. D.&C. 4th 449 (Pa. Com. Pl. 2002) (Luzerne Cty.), *aff'd*, 842 A.2d 409 (Pa. Super. 2004) (*en banc*) (bad faith where insurer failed to re-examine its settlement figure despite evidence showing claim was worth far more than the amount offered by the insurer, insurer conducted no reasonable investigation for over a year, and insurer took inconsistent positions);

- *Rosborough v. Farmers Mut. Fire Ins. Co.*, 74 Pa. D.&C. 4th 404 (Pa. Com. Pl. 2005) (Washington Cty.) (bad faith where insurer continued to rely on single witness who was later discredited and failed to conduct additional investigation);

- *Rosewood Cancer Care, Inc. v. Travelers Indemnity Co.*, Civ. Act. No. 14-434, 2016 WL 5407731 (W.D. Pa., Sept. 28, 2016) (bad faith where insurer failed to respond to seven requests for an explanation for its coverage decision);

- *Craker v. State Farm Mut. Auto. Ins. Co.*, Civ. Act. No. 11-225, 2012 WL 1134807 (W.D. Pa., Apr. 4, 2012) (insurer's failure to reconsider value of the claim after receipt of new evidence can be bad faith);

- *Amitia v. Nationwide Mut. Ins. Co.*, No. 3:08cv335, 2009 WL 111578 (M.D. Pa., Jan. 15, 2009) (failure to conduct a timely and thorough investigation was a form of bad faith).

The Superior Court below likewise held that insurers have an affirmative obligation to conduct a reasonable investigation, stating that the "insurer must actively undertake a meaningful investigation to obtain accurate information bearing upon the coverage inquiry." *Rancosky*, 130 A.3d at 98.

All of the decisions referenced above are consistent with the Unfair Insurance Practices Act, which makes it clear that insurers engage in unfair claims settlement or compromise practices by:

> (ii) Failing to acknowledge and act promptly upon written or oral communications with respect to claims arising under insurance policies.
>
> (iii) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies. [and]
>
> (iv) Refusing to pay claims without conducting a reasonable investigation based upon all available information.

40 P.S. § 1171.5(a)(10).

Because, as this Court recognized in *Toy*, Section 8371 applies to the entire course of the insurer's conduct once the insurer has been called upon to perform its contractual obligations, lower courts have applied the two-part test of *Terletsky* to reflect that scope. As a result of those lower court decisions, the two-part *Terletsky* test has developed into the following standard:

> The insurer acts in "bad faith" under Section 8371 if, when called upon to perform its contractual obligations (1) the insurer's act, or failure to act, lacked a reasonable basis, and (2) the insurer knowingly or recklessly disregarded the insured's rights.

This Court should formally adopt this standard, not only because it is consistent with the vast body of lower court decisions that have applied Section 8371, but because it is more than adequate to put insurers on notice of the type of behavior that can expose them to liability under Section 8371.

III. Pennsylvania Law Does Not Require Proof of Evil Motive to Recover Punitive Damages

Conseco's attempt to buttress its argument by examining the law of punitive damages is misguided. Contrary to Conseco's argument, Pennsylvania does not require proof of evil motive in order to recover punitive damages. In fact, the standard for punitive damages is wholly consistent with the *Terletsky* two-part test.

The roots of the current approach to punitive damage in Pennsylvania trace back to 1963, when this Court decided *Chambers v. Montgomery*, 192 A.2d 355 (Pa. 1963). The Court in *Chambers* adopted the guidelines for imposing punitive damages set forth in the Restatement (Second) of Torts, §908(2). That section provides, in relevant part:

> Punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive **or** his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of the defendant's acts, the nature and extent

> of the harm to the plaintiff that the defendant caused or intended to cause and the wealth of the defendant.

Restatement (Second) of Torts, §908(2) (emphasis added).

Significantly, the Restatement recognizes two alternative ways to show that conduct is outrageous. While the first alternative refers to an "evil motive," the second does not. Instead, the second alternative simply requires showing a "reckless indifference to the rights of others."

After adopting the Restatement approach in *Chambers*, this Court repeatedly confirmed that recklessness is sufficient to recover punitive damages. *See*, *e.g.*, *Chambers*, 192 A.2d at 358 (specifically including "reckless" among the types of conduct that are sufficient to support an award of punitive damages); *Feld v. Merriam*, 485 A.2d 742, 748 (Pa. 1984) (same); *Martin v. Johns Manville*, 494 A.2d 1088, 1097 (Pa. 1985).

All of these cases were handed down before the Pennsylvania Legislature enacted Section 8371, which authorized an award of punitive damages. Accordingly, when the legislators enacted that statute, they knew that punitive damages could be awarded on a showing of reckless indifference to the rights of others. They further knew that it was not necessary to prove bad motive in order to recover punitive damages. Under standard rules of statutory construction, therefore, it must be presumed that the legislators understood what was required,

and what was not required, to recover punitive damages when they authorized that relief in Section 8371. *See Birth Center*, 787 A.2d 376 (Pa. 2001).

The opinion of the Superior Court in the instant case is consistent with established Pennsylvania law regarding punitive damages. The Superior Court applied the two-part *Terletsky* standard, which requires proof that the insurer "knew or recklessly disregarded" its lack of reasonable basis in denying the claim. *See Rancosky*, 130 A.3d at 91. The reference to "recklessly disregarded" matches the "reckless indifference" standard that this Court adopted in *Chambers* for proving punitive damages. Additionally, the Superior Court found that "a 'dishonest purpose' or 'motive of self-interest or ill will' is not a third element required for a finding of bad faith." *Id.* As demonstrated above, a dishonest purpose, motive of self-interest or ill will is not an element required for an award of punitive damages. Accordingly, the ruling by the Superior Court below regarding the bad faith statute is entirely consistent with Pennsylvania's approach to punitive damages.

Conseco's constitutional due process argument therefore is unfounded. Because the Superior Court's opinion is in accord with established Pennsylvania law on punitive damages, Conseco had "fair notice" of the conduct that would subject it to such damages. To support its argument, Conseco relies principally on this Court's decision in *Hutchison v. Luddy*, 870 A.2d 766 (Pa. 2005). However,

Conseco itself quotes the standard set forth in *Hutchison*, which permits punitive damages *either* because of the defendant's evil motive *or* because of his reckless indifference to the rights of others. *See* Appellant's Brief, p. 44. Put simply, Conseco is trying to twist the two alternative ways of proving punitive damages from a *disjunctive* test to a *conjunctive* test.

The Superior Court rejected a similar attempt in *Focht v. Rabada*, 268 A.2d 157 (Pa. Super. 1970). Like Conseco here, the defendant in *Focht* argued that a party must prove bad motive in order to recover punitive damages. After quoting the standard for awarding punitive damages that this Court adopted in *Chambers*, the Superior Court stated that "defendant's conclusion from *Chambers* that wrong motive or a prior relationship between the parties must exist in all cases before such damages will be imposed is in error." 268 A.2d at 160.

Conseco also tries to suggest that the Superior Court below somehow overlooked the state of mind required to award punitive damages. However, Conseco itself recognizes that punitive damages can be based on recklessness. *Id.* Although Conseco refers to a definition of recklessness in Section 500 of the Restatement, that section addresses situations where personal safety is at stake. That obviously is not the case here.

In discussing Section 500, this Court observed that the Restatement describes two types of recklessness:

> (1) where the "actor knows, or has reason to know, . . . of facts which create a high degree of risk of physical harm to another, and deliberately proceeds to act, or to fail to act, in conscious disregard of, or indifference to, that risk;" and
>
> (2) where the "actor has such knowledge, or reason to know, of the facts, but does not realize or appreciate the high degree of risk involved, although a reasonable man in his position would do so."

See Restatement (Second), Torts, §500. After examining these two types of recklessness, the Court found that only the first is sufficient to justify punitive damages, explaining that "an appreciation of the risk [of harm] is a necessary element of the mental state required for the imposition of [punitive] damages." *Martin*, 494 A.2d at 1097 n. 12. As the Court observed, the goal of punitive damages is deterrence, and "[i]t is impossible to deter a person from taking risky action if he is not conscious of the risk. . . . Therefore, an appreciation of the risk is a necessary element of the mental state required for the imposition of such damages." *Id.*

Applying this rationale to situations involving bad faith by an insurance company, insurers are fully aware whenever they act or fail to act without a reasonable basis that there is a high risk – if not a certainty – that the policyholder will be harmed. Awarding punitive damages against insurers in those instances therefore would serve the deterrent effect those damages are intended to have. In particular, there is no doubt that insurers are fully aware that certain actions create

a high degree of risk of harm to the insured – namely, any act (or failure to act) that violates the UIPA or that is prohibited by well-established judicial precedent. The insurance industry's knowledge of the UIPA and case law goes beyond the mere presumed knowledge of the law that applies to all citizens. The UIPA specifically targeted the insurance industry. No insurer could ever claim to be unaware of that statute, and it would be nonsensical to force a policyholder to prove that an insurer was subjectively aware of the statute or of the harm that could result from violating the statute.

Consequently, a violation of the UIPA is not at all like the facts in *Martin*, where the plaintiff merely alleged that the defendants "had access to certain literature which discusses generally the risks [of asbestos] in question and are subject to punitive damages because they nevertheless failed to provide adequate warning labels on their products." 494 A.2d at 1100. Unlike the company in *Martin*, the insurance industry does not simply have access to literature outlining the risks of harm from bad faith conduct. Rather, the insurance industry is fully aware of the UIPA and all of the harmful conduct that it proscribes.

While the insurer in this case wants the Court to impose a malevolent intent requirement to award punitive damages in the context of Section 8371, the Court has not imposed that requirement in other contexts. For example, the Court adopted comment d of Section 500 of the Restatement, which provides that "if the

conduct involves a high degree of chance that serious harm will result, the fact that [the defendant] knows or has reason to know that others are within the range of its effect is conclusive of his recklessness." *See* Restatement (Second), Torts, §500 com. (d); *see also Evans v. Phila. Trans. Co.*, 212 A.2d 440 (1965). The Court also has long held that punitive damages may be imposed on employers for the tortious acts of their employees. *See Lake Shore & Mich.S.Railway v. Rosenzweig*, 6 A. 545 (Pa. 1886). Similarly, the Superior Court has held that a successor corporation can be liable for punitive damages. *Martin v. Johns-Manville Corp.*, 469 A.2d 655, 667 (Pa. Super. Ct. 1983), *rev'd on other grounds*, 494 A.2d 1088 (Pa. 1985).

Thus, proving a malevolent intent is not a prerequisite for awarding punitive damages against a corporate entity, and it should not be a prerequisite for awarding punitive damages against an insurer under Section 8371.

CONCLUSION

For all the reasons discussed herein, United Policyholders respectfully requests this Court to affirm the holding of the Superior Court in this case by (1) rejecting the contention by Conseco and its amici that the "motive of self-interest or ill will" is a separate, third element require to prove bad faith under § 8371; and (2) adopting the standard for proving bad faith set forth above.

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Dated: January 19, 2017

CERTIFICATE OF COMPLIANCE

Pursuant to Pennsylvania Rules of Appellate Procedure 531 and 2135, the length of this amicus curiae brief is 6,579, in compliance with the word count limit of 7,000 words.

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Dated: January 19, 2017