"Bad Faith" in Michigan Insurance Coverage Litigation

By Jonathan R. Moothart

The explosion of insurance coverage litigation, particularly in the environmental arena, has given rise to a close scrutiny by attorneys involved in such actions of the potential causes of action to effectuate insurance coverage. Many insurance policies contractually shorten[1] the limitations period for bringing suit against the insurer, and the necessity for overcoming this generally enforceable[2] contractual limitations period has been the mother of the invention of some creative pleading to establish viable causes of action not sounding strictly in contract.

Also, insurers understandably have a tendency to be unresponsive to insurance claims which the insurer believes to be questionable on the coverage issue. This perceived apathy on the part of the insurer for the plight of the insured, who is often facing fines, defense costs, bills for environmental remediation, or repair of his or her home or other property, can cause the insured to feel that he or she is not being dealt with fairly—that the insurer has dealt with him or her in "bad faith." The insured may feel that the insurer has not only breached the contract, but that it has done so willfully or wantonly. A plaintiff seeking exemplary or emotional distress damages based on this type of conduct will only rarely find them in a contract action;[3] such damages are more often available, however, in tort.

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Although some degree of skill and care is implied into every act which one takes, including those taken pursuant to a contract,[4] and some contracts are specifically subject to implied obligations of good faith in their performance,[5] the nonperformance of a contractual obligation generally gives rise only to a cause of action for breach of contract; a tort claim based on such nonfeasance will not lie.[6]

In *Kewin v Massachusetts Mutual Life Ins Co*,[7] the Michigan Supreme Court applied this general rule in the context of insurance contracts, holding that "the mere bad faith breach of an insurance indemnity contract [is not] an independent and separately actionable tort."[8] The essence of the Michigan Supreme Court's holding in *Kewin* is that it does not matter whether a breach of an insurance contract occurs innocently, negligently, wantonly, maliciously, or viciously; breach of contract is the cause of action that is proper and the damages available are contract damages only.[9]

The concept of "bad faith" does, however, have a proper place in certain types of insurance coverage litigation. What follows is an analysis of four areas in which courts have been willing to consider claims for damages in addition to or different from those usually available in ordinary breach of contract actions based on allegations of affirmative misconduct by an insurer.

1. Tort actions arising out of the insurer-insured relationship "not on the policy." In *Hearn v Rickenbacker*,[10] the plaintiff sued the defendant insurance company and the company's agent for breach of contract, fraud, and

negligence based on the agent's alleged mishandling of premium payments. Suit was not filed, however, until after the expiration of the one-year contractual limitations period in the insurance contract. The plaintiff alleged fraud and negligence to overcome this contractual limitations hurdle. The insurer in *Hearn* argued that the contractual limitations period should apply to any actions arising out of the policy, including those which were not strictly breach of contract claims. The court recognized that the "breach of an insurer's duty to act in good faith in the handling and payment of claims [is] a tort not recognized in this state" [citing *Kewin*], but nevertheless held that the plaintiff in that case had properly pleaded fraud and negligence as causes of action not "on the policy."[11]

The court stated:

> *As the Court of Appeals has observed in the past, the relationship between insurers and their insureds is "sufficient to permit fraud to be predicated upon a misrepresentation."* Drouillard v Metropolitan Life Ins Co, *107 Mich App 608, 621, 310 NW2d 15 (1981)... An action for fraud is not an action on the policy; it is an action in tort that arose when the fraud was perpetrated....*
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> *The same reasoning applies to the plaintiff's negligence claims. If the defendant has breached a legal duty owed to the plaintiff apart from the contract of insurance, then there may be liability in tort....Although mere allegations of failure to discharge obligations under the insurance contract would not be actionable in tort,* Kewin, supra, *page 423, 295 NW2d 50, where, as here, the breach of separate and independent duties are [sic] alleged, plaintiff should be allowed an opportunity to prove his causes of action.*[12]

The difference between actions "on the policy" and "not on the policy" is not an issue which has been fleshed out in great detail by Michigan courts. Generally, claims based on acts or omissions of the insurer prior to the submission of a claim by the insured seem more likely to pass muster.[13] Most cases dealing with claims of misconduct by insurers handling claims after they have been filed with the company have been treated as breach of contract claims "dressed up as torts." For example, in *Crossley v Allstate Ins Co*,[14] the court stated "to the extent plaintiff's complaint alleges 'negligence' in defendant's refusal to pay, or failure to more properly investigate and assess the merit of plaintiff's claim, the complaint merely alleges a breach of contract, and summary disposition would properly have been granted with respect to such a 'negligence' claim."[15] Other plaintiffs have met a similar fate.[16]

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In *Wendt v Auto-Owners Ins Co*,[17] however, the Michigan Court of Appeals, although recognizing the *Kewin* prohibition of recovery for emotional distress and mental anguish in the context of insurance contracts, nevertheless held that "the breach of an insurer's obligation to process a claim in good faith renders an insurer liable for pecuniary losses which are not otherwise compensated for by statute."[18] In addition to holding that the plaintiff's breach of contract damages could include damages flowing from a "bad faith" processing of a claim, the court also reversed the circuit court's decision to strike the plaintiff's claims for damages based on the defendant's alleged negligence in handling the claim. Although it appears that the issue of whether this "negligent adjustment" claim was proper in the first instance was not before the *Wendt* court, the court's obvious knowledge of the *Kewin* decision combined with its tacit recognition of the negligence cause of action is some authority for the proposition that such a claim is proper under certain circumstances.

2. **Uniform Trade Practices Act.** The purpose of the Michigan Uniform Trade Practices Act[19] is "to regulate trade practices in the business of insurance...."[20] The UTPA covers a broad range of insurance industry practices, and requires payment of insurance benefits on a timely basis.[21] Although the Act does not create a private cause of action in tort against an insurer for violation of its timely payment provisions,[22] it does provide a means for the insured to recover 12% simple interest on its claim from a date 60 days after satisfactory proof of loss is received by the insurer. The statute contemplates at least two types of interest claimants: (1) third-party tort claimants, and (2) first-party claims by insureds directly against their own insurers.

With regard to third-party tort claimants, interest is only available when "the claim is not reasonably in dispute and the insurer has refused payment in bad faith, such bad faith having been determined by a court of law."[23] This "bad faith" standard is an exceedingly difficult one to meet. In

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Medley v Canady[24] the Court of Appeals held that the UTPA "is intended as a penalty to be assessed against insurers who procrastinate in paying meritorious claims in 'bad faith'. . . . As a penalty, the statute is to be strictly construed."[25] Consistent with its construction of UTPA interest as punitive rather than compensatory, the court held that the term "bad faith" as used in the UTPA is "not simply negligence or bad judgment but rather the conscious doing of a wrong because of dishonest purpose or moral obliquity. It is not merely the lack of good faith, but the opposite of good faith."[26]

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In first-party actions, "bad faith" is not a prerequisite to a claim for penalty interest; however, Michigan courts have consistently held that a first-party claimant must prove that its claim is "not reasonably in dispute" in order to be awarded UTPA interest.[27]

Unlike Michigan's interest on money judgments statute,[28] interest payable under the UTPA is "simple interest" and is not compounded on an annual basis. Accordingly, as a claimant essentially must choose between the interest payable under the money judgments statute and UTPA interest during time periods when both types of interest are accruing,[29] it is important to accurately calculate interest under both statutes to determine which is more advantageous.

3. Bad faith refusal to settle. It is well established in Michigan that if an insurance company refuses in "bad faith" to settle a claim on behalf of its insured, the insurer is liable for any excess judgment over and above policy limits which is eventually rendered against its insured.[30] The insurer's liability, however, extends only to the insured's actual ability to pay; i.e., the insurer is not liable to pay an excess judgment if its insured would be financially unable to pay that judgment.[31]

4. "Overdue benefits" under the Michigan No-Fault Act. Michigan's No-Fault Act allows recovery of reasonable attorney fees "for advising and representing a claimant in an action for personal or property protection insurance benefits which are overdue."[32] It is proper for a court to award no-fault attorney fees in addition to the 12% UTPA interest;[33] however, the court must find that the insurer acted "unreasonably" in order to award fees under the No-Fault Act.[34]

CONCLUSION

The concept of "bad faith" in Michigan insurance coverage litigation has different meanings depending on the context. A thorough knowledge of the law applicable to its meaning in specific situations is a must for attorneys representing plaintiffs or defendants in insurance coverage cases. ■

Footnotes

1. A common provision is a one-year limitation based on MCL 500.2832; MSA 24.12832.
2. *Lehr v Professional Underwriters*, 296 Mich 693, 296 NW 843 (1941). *Cf.* MCL 500.4046, 500.4244; MSA 24.14046, 24.14244 (limitations period shorter than six years prohibited for actions on life policies). Note that such limitations periods are generally tolled from the time the insured gives notice of the loss until the insurer formally denies coverage. *In re Certified Question, Ford Motor Co v Lumbermens Mutual Casualty Co*, 413 Mich 22, 319 NW2d 320 (1982).
3. *See, e.g., Stewart v Rudner*, 349 Mich 459, 84 NW2d 816 (1957) (emotional distress damages properly awarded for breach of contract to perform Caesarean section).
4. *Hart v Ludwig*, 347 Mich 559, 79 NW2d 895 (1956).
5. MCL 440.1203; MSA 19.1203.
6. *Hart v Ludwig, supra.*
7. 409 Mich 401, 295 NW2d 50 (1980).
8. *Id.*, 409 Mich at 423, 295 NW2d at 56.
9. *Id.* Other states, most notably California, have reached a different result. *See e.g., Gruenberg v Aetna Ins Co*, 9 Cal 3d 566, 108 Cal. Rptr. 480, 510 P2d 1032 (1973) (California court recognizing cause of action in tort for insurer's breach of an implied duty of good faith fair dealing and allowing recovery of emotional distress damages).
10. 428 Mich 32, 400 NW2d 90 (1987).
11. *Id.*, 428 Mich at 37-38, 400 NW2d at 93.
12. *Id.*, 428 Mich at 38-39, 400 NW2d at 93-94.
13. *E.g., Hearn, supra*, involving the agent's alleged mishandling of premium payments. The court in *Hearn* expressed "no opinion on the question whether allegations of fraud in the settlement of a claim would amount to an action on the policy. Likewise, an allegation of negligence in an insurer's failure to adjust presents a different situation, which we do not address here." *Id.* at note 3. *See also Kassab v Michigan Basic Property Insurance Ass'n*, 185 Mich App 206, 460 NW2d 300 (1990) (holding that the plaintiff had stated a viable cause of action for fraud based on representations made to him at a time prior to the subject loss, as well as a proper cause of action based on the denial by the insurer of the full and equal enjoyment of his fire insurance policy because of his national origin).
14. 155 Mich App 694, 400 NW2d 625 (1986).
15. *Id.*, 155 Mich App at 697-698, 400 NW2d at 628.
16. *Tennant v State Farm Mutual Automobile Ins Co*, 143 Mich App 419, 372 NW2d 582 (1985) (allegations that insurer failed to properly investigate plaintiff's need for rehabilitation and to provide a rehabilitation program held to be "claims on the policy"); *Van Marter v American Fidelity Ins Co*, 114 Mich App 171, 318 NW2d 679 (1982) (court holding that claim for intentional infliction of emotional distress not proper where plaintiff's claim was in reality merely one for breach of an insurance contract).
17. 156 Mich App 19, 401 NW2d 375 (1986).
18. *Id.*, 156 Mich App at 27-28, 401 NW2d at 379-380.
19. MCL 500.2001 *et seq.*; MSA 24.12001 *et seq.*
20. MCL 500.2002; MSA 24.12002.
21. MCL 500.2006; MSA 24.12006.
22. *Young v Michigan Mutual Ins Co*, 139 Mich App 600, 362 NW2d 844 (1984).
23. MCL 500.2006(4); MSA 24.12006(4).
24. 126 Mich App 739, 337 NW2d 909 (1983).
25. *Id.*, 126 Mich App at 743-744, 337 NW2d at 911.

26. *Id.*, 126 Mich App at 748, 337 NW2d at 913.
27. *Siller v Employer's Insurance of Wausau*, 123 Mich App 140, 143-144, 333 NW2d 197, 199 (1983) ("an insurer may refuse to pay a claim and be relieved of paying interest on the claim only when 'the claim is reasonably in dispute'"). *See also Norgan v American Way Life Ins Co*, 188 Mich App 158, 164-165, 469 NW2d 23, 26-27 (1991). The addition of the "not reasonably in dispute" requirement in first-party actions is apparently taken from subsection 1 of MCL 500.2006; MSA 24.12006, which states, in pertinent part, that "a person must pay on a timely basis to its insured... the benefits provided under the terms of the policy, or, in the alternative, 12% interest... on claims not paid on a timely basis. Failure to pay claims on a timely basis or to pay interest on claims... is an unfair trade practice unless the claim is reasonably in dispute." Clearly, this statute by its terms requires the payment of interest by the insurer whether or not the claim is "reasonably in dispute" in a first-party case. The statute merely provides that the insurer's failure to pay this interest is not an "unfair trade practice" if the claim is reasonably in dispute. Decisions adding the "not reasonably in dispute" requirement as a prerequisite to the award of UTPA interest improperly hold that UTPA interest is available only when the insurer has committed an unfair trade practice (which, under the statute, is the failure to pay interest as required). Although this approach of the Court of Appeals is consistent with its construction of the statute as punitive rather than compensatory, it is clearly a misreading of the statutory language.
28. MCL 600.6013; MSA 27A.6013.
29. *McCahill v Commercial Union Ins Co*, 179 Mich App 761, 779-780, 446 NW2d 579, 587-588 (1989) ("prevailing party should be entitled to recover both types of interest.... [However, UTPA interest] must be offset by any award of interest [including statutory judgment interest] that is payable by the insurer pursuant to the award").
30. *Commercial Union Ins Co v Liberty Mutual Ins Co*, 426 Mich 127, 393 NW2d 161 (1986) (holding that in this context, "there can be bad faith without actual dishonesty or fraud" and giving 12 factors Michigan courts will consider in determining whether refusal to settle was in "bad faith").
31. *Frankenmuth Mutual Ins Co v Keely*, 436 Mich 372, 461 NW2d 666 (1990).
32. MCL 500.3148; MSA 24.13148.
33. *Van Marter*, *supra* at note 16.
34. MCL 500.3148; MSA 24.13148; *Wood v DAIIE*, 413 Mich 573, 321 NW2d 653 (1982).

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See the December 1990 Bar Journal *at page 1259 for more information.*