The Legal Intelligencer
THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2017
PHILADELPHIA, FRIDAY, NOVEMBER 2, 2017
An ALM Publication

High Court Decides Elements of Bad Faith Cause of Action Under 42 Pa.C.S.

In 1990, the Pennsylvania General Assembly enacted Pennsylvania's insurance bad faith statute, codified at 42 Pa.C.S. §8371 (Section 8371).

BY KENNETH M. PORTNER

Of the Legal Staff

In 1990, the Pennsylvania General Assembly enacted Pennsylvania's insurance bad faith statute, codified at 42 Pa.C.S. Section 8371. Section 8371 is generally considered to have been the General Assembly's reaction to the Pennsylvania Supreme Court's decision in *D'Ambrosio v. Pennsylvania National Mutual Casualty Insurance*, 494 Pa. 501, 502, 431 A.2d 966, 967 (1981). In *D'Ambrosio*, a policyholder sued his insurance company over the denial of a claim for damage to his home. In addition to suing in assumpsit for benefits under the policy, the insured asserted a cause of action in trespass for emotional distress and punitive damages because of the insurer's alleged "bad faith" conduct in denying the claim.

Kenneth M. Portner.

Although the Supreme Court considered and discussed the parameters of a bad faith cause of action, it declined to create a cause of action in trespass for alleged bad faith conduct of an insurer seeking punitive damages and damages for emotional distress. The court wrote that it was for the Legislature to determine whether such a cause of action should be created.

Section 8371 is quite brief, consisting of one sentence. The complete statement of the cause of action itself is as follows: "In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions: …" The court may award a successful claimant the amount of the claim plus interest, punitive damages and court costs and attorney fees. Section 8371's brevity left many unanswered questions: What was the plaintiff's burden of proof? Which statute of limitations applied? Was there a right to a jury trial? Was a court required to award punitive damages if it made a finding of bad faith?

In the years since the Section 8371's enactment, the Supreme Court has answered these questions. Surprisingly, however, until last month the Supreme

Court had not addressed the fundamental question of the elements of a bad faith insurance claim brought pursuant to the statute. That gap was filled by the Supreme Court's decision in *Rancosky v. Washington National Insurance*, No. 28 WAP 2016, 2017 Pa. LEXIS 2286, at *1 (Sep. 28).

Since 1994, the generally accepted definition of "bad faith" and the elements of the cause of action were those adopted by the Superior Court in *Terletsky v. Prudential Property & Casualty Insurance*, 437 Pa. Super. 108, 124, 649 A.2d 680, 688 (1994). In that case, the Superior Court observed that in the insurance context the term "bad faith" had acquired a particular meaning:

"Bad faith" on part of insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith.

Terletsky, 437 Pa. Super. 125, 649 A.2d at 688, quoting Black's Law Dictionary 139 (6th ed.1990). The Superior Court held that to recover under a claim of bad faith, the plaintiff must show that the defendant did not have a reasonable basis for denying benefits and that the defendant knew or disregarded its lack of reasonable basis.

Rancosky involved a claim under a disability insurance policy. The policy included a waiver of premium provision which excused payment of premiums after the insured was disabled for 90 days. Leann Rancosky claimed she was protected by this provision whereas the insurer denied the claim based upon the insured's failure to pay premiums. The insurer's position was based upon a mistaken identification of Rancosky's date of disability. The insurer failed to investigate the discrepancy in the start date of the disability.

Rancosky sued the insurer for breach of contract and bad faith under Section 8371. The trial court found that the insurer was sloppy and even negligent in its claims handling. Nonetheless, it found in favor of the insurer on the bad faith claim due to its conclusion that Rancosky failed to prove that the insurer lacked a reasonable basis to deny benefits. This conclusion was based on the trial court's finding that Rancosky had not proved that the insurer acted out of some motive of self-interest or ill-will.

The Superior Court vacated the trial court's opinion. It observed that the first prong of the *Terletsky* test (whether the insurer lacked a reasonable basis for denying benefits) was an objective test. The insurer's subjective intent—its motive of self-interest or ill-will—was irrelevant. The trial court's conclusion that Rancosky failed to prove a lack of reasonable basis because she did not prove the insurer acted with ill-will, was therefore erroneous. The Superior Court further observed that while self-interest or ill-will is relevant to the second prong of the test, whether the insurer knew or recklessly disregarded its lack of reasonable basis, it is not required proof. The court determined that the insurer lacked a reasonable basis on which to deny benefits. It remanded to the trial court to determine whether the insurer

knew or recklessly disregarded its lack of reasonable basis.

On appeal, the question before the Supreme Court was whether the court should ratify the requirements of *Terletsky*, and whether the Superior Court's conclusion that proof of self-interest or ill-will was not required to make out a case should be affirmed.

The court began its analysis with a review of the history of the bad faith cause of action in Pennsylvania and of the *Terletsky* test. It noted that the test did not reference self-interest or ill-will. Instead, the *Terletsky* court's citation to Black's Law Dictionary inadvertently created confusion as to the relationship between the two-prong test and the seemingly additional requirement of proving a subjectively improper motive on the part of the insurance company.

Rancosky, 2017 Pa. LEXIS 2286, at *21., accordingly, the longstanding standard in Pennsylvania had been the Superior Court's two-pronged test in *Terletsky* and its subsequent clarification that self-interest and ill-will, while probative, is not required.

The Supreme Court reasoned that since the General Assembly adopted Section 8371 in response to D'Ambrosio's invitation to create a right of action for bad faith, it stands to reason that the Legislature intended to adopt the *D'Ambrosio* court's understanding of bad faith. The D'Ambrosio court's definition of bad faith encompassed both intentional and reckless conduct. The court therefore concluded that *Terletsky's* formulation of the cause of action allowing proof of either intentional or reckless conduct to support liability was appropriate.

In summary, the Supreme Court held that to prevail in a bad faith insurance claim pursuant to Section 8371, a plaintiff must demonstrate, by clear and convincing evidence, that the insurer did not have a reasonable basis for denying benefits under the policy and that the insurer knew or recklessly disregarded its lack of a reasonable basis in denying the claim. It further held that proof of the insurer's subjective motive of self-interest or ill-will is not an element of the cause of action. Instead, proof of the insurer's knowledge or reckless disregard for its lack of reasonable basis in denying the claim goes only to satisfaction of the second prong.

While deciding an issue of first impression for the court, the *Rancosky* decision does not truly break new ground in Pennsylvania bad faith jurisprudence. As a practical matter, the court confirmed a standard that has been applied for many years. The opinion does, however, put an end to the lingering dispute over the importance of proof of an insurer's motive to a bad faith cause of action.

Kenneth M. Portner, a patner at Weber Gallagher Simpson Stapleton Fires & Newby, represents insurance companies. His insurance practice includes coverage and bad faith avoidance matters and E&O matters. He regularly appears in state and federal courts in New Jersey, New York and Pennsylvania. Contact him at kportner@wglaw.com.