

Scott Seaman Provides Analysis on Pennsylvania Supreme Court Bad Faith Decision

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The Pennsylvania Supreme Court has weighed in for the first time on the standard for proving statutory bad faith under Pennsylvania law. There is no common law action for bad faith in Pennsylvania so a policyholder's road to a bad faith recovery runs through the bad faith statute enacted by the Pennsylvania legislature. The statute, 42 Pa. C.S.A. § 8371, provides:

§ 8371. Actions on insurance policies.

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:

1. Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
2. Award punitive damages against the insurer.
3. Assess court costs and attorney fees against the insurer.

The statute does not provide a definition of "bad faith" and does not set forth the elements to establish bad faith.

Earlier this week, in *Rancosky v. Washington National Insurance Company*, No. 28 WAP 2016 (Pa. Sept. 28, 2017) the Pennsylvania Supreme Court adopted the two-part test for proving a statutory "bad faith" claim enunciated by the appellate court decision in *Terletsky v. Prudential Property & Casualty Insurance Company*, 649 A.2d 680 (Pa. App. 1994). To prevail upon a bad faith claim, a policyholder must establish by "clear and convincing evidence" that (1) the insurer did not have a reasonable basis for denying benefits under the policy and (2) the insurer knew of or recklessly disregarded its lack of a reasonable basis." The key point of the decision was that the court rejected the insurer's argument that the second element requires proof of an insurance company's motive of self-interest or ill-will. The Pennsylvania Supreme Court said such evidence may be probative of the second prong, but is not a required element. The insurer's argument of a requirement of showing ill-will was not created out of

thin air. The *Terletsky* decision injected the issue because it cited to Black’s Law Dictionary and quoted language about bad faith involving self-interest or ill will. Multiple Pennsylvania decisions have held the policyholder must prove self-interest or ill will.

The Pennsylvania Supreme Court did not reach the result insurers had desired. *Rancosky* involved a dispute over benefits under a “cancer” insurance policy and a policyholder battling the disease. In that sense the notion of hard facts making bad law may be at play.

Even in the wake of *Rancosky*, an insurer that is merely incorrect in denying policy benefits is not in bad faith. It must have been unreasonable. Further, an insurer must know it did not have a reasonable basis to deny benefits or recklessly disregarded its lack of a reasonable basis — mere negligence is not enough for bad faith liability. Importantly, the policyholder still must prove these two elements by clear and convincing evidence. To satisfy their burden of proof, in many instances the policyholder must still proffer compelling evidence of insurer’s state of mind or improper conduct amounting to recklessness.

Perhaps, the most problematic part of the opinion is that the Court held that the two-part test (sans a showing of “self-interest” or “ill will”) applies to awards of punitive damages. The decision did not analyze or give due consideration to “due process” and other constitutional issues associated with awards of punitive damages. Insurers should plead, argue, and preserve appropriate constitutional issues where punitive damages are sought. In some cases, the *Terletsky* test, as adopted in *Rancosky*, may not satisfy the reprehensibility requirements needed to sustain a punitive award. Of course, the amount of the punitive award or the amount in relation to compensatory damages may not satisfy constitutional standards.

Scott Seaman, a Chicago-based partner and co-char of the firm’s national Insurance Services Practice Group, was quoted in *Law360*’s article on the Pennsylvania Supreme Court’s bad faith decision. Read “[Pa. Ruling Won’t Lower Bar To Prove Insurer Bad Faith](#)” on the *Law360* website (*subscription required*).

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