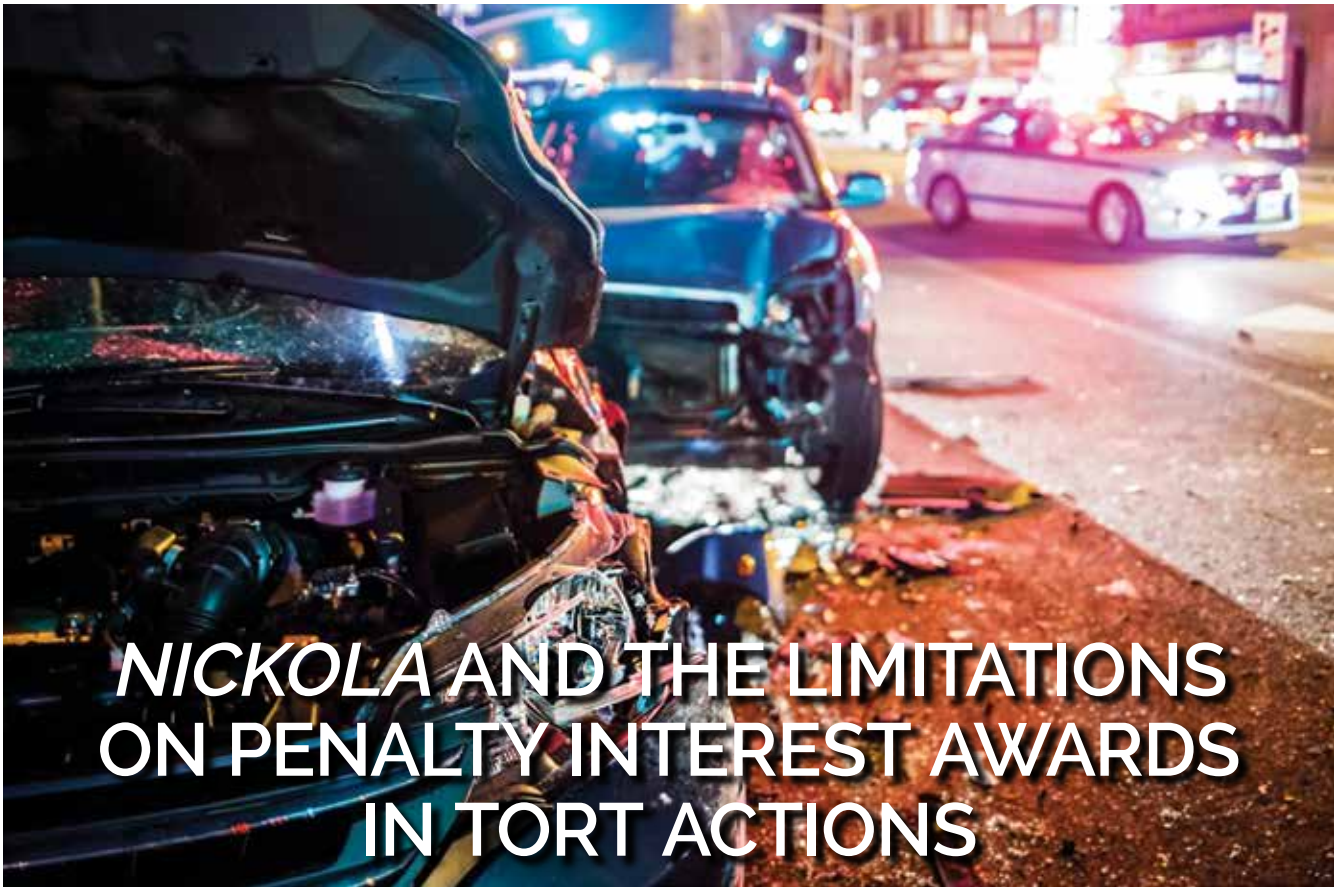

NICKOLA AND THE LIMITATIONS ON PENALTY INTEREST AWARDS IN TORT ACTIONS

By James Bradley and Drew W. Broaddus

Although MCL 500.2006(4) has long provided for the imposition of 12 percent "penalty" interest on insurers who are "delinquent" in paying first-party (as well as certain third-party) claims,[1] this provision is receiving renewed attention in light of the Michigan Supreme Court's decision in *Nickola v MIC General Insurance Company*.[2] While *Nickola* dealt with underinsured motorist (UIM) benefits, the overlap between UIM and tort claims[3] has led some to interpret *Nickola* as expanding the situations in which third-party claimants can recover penalty interest. However, a thorough reading of this opinion confirms that *Nickola* has little impact outside of the underinsured motorist and uninsured motorist contexts. The standard to recover under § 2006(4) remains high for true third-party tort claimants who have no contractual relationship with the insurer.

MCL 500.2006

Chapter 20 of the Insurance Code, MCL 500.2001 *et seq.*, is the Uniform Trade Practices Act enacted as 273 PA 1976, effective April 1, 1977.[4] This legislation was designed to bring Michigan's Trade Practices Act into general conformity with the model act approved by the National Association of Insurance Commissioners in the early 1970s, and it defines and prohibits unfair trade practices in the insurance business.[5] Unfair trade practices—generally described as unfair methods of competition or unfair or deceptive acts—are specifically defined within Chapter 20.[6] This chapter also authorizes the insurance commissioner, upon an administrative finding of unfair trade practices, to order fines and other sanctions up to and including suspension or revocation of the violator's license or certificate of authority for knowing and persistent violations.[7] "In other words, Chapter 20 is a 'do not' list addressed to insurers and their agents that is backed by a penalty system, which includes at the ultimate, a commercial death penalty, i.e., revocation of certificate of authority or license."[8]

But the penalty interest provision, MCL 500.2006, "contrasts with other provisions of Chapter 20 in that it places affirmative duties upon insurers rather than simply stating prohibitions."[9] MCL 500.2006(1) mandates timely payment of benefits and

imposes an interest obligation "as provided in subsection (4)" when payment is not timely:[10]

> A person must pay on a timely basis to its insured, a person directly entitled to benefits under its insured's insurance contract, or a third party tort claimant the benefits provided under the terms of its policy, or, in the alternative, the person must pay to its insured, a person directly entitled to benefits under its insured's insurance contract, or a third party tort claimant 12% interest, as provided in subsection (4), on claims not paid on a timely basis. Failure to pay claims on a timely basis or to pay interest on claims as provided in subsection (4) is an unfair trade practice *unless the claim is reasonably in dispute*. (Emphasis added.)

And MCL 500.2006(4) states in pertinent part:

> If benefits are not paid on a timely basis, the benefits paid bear simple interest from a date 60 days after satisfactory proof of loss was received by the insurer at the rate of 12% per annum, if the claimant is the insured or a person directly entitled to benefits under the insured's insurance contract. *If the claimant is a third party tort claimant, the benefits paid bear interest from a date 60 days after satisfactory proof of loss was received by the insurer at the rate of 12% per annum if the liability of the insurer for the claim is not reasonably in dispute, the insurer has refused payment in bad faith, and the bad faith was determined by a court of law.* (Emphasis added.)

As a penalty, the statute is to be strictly construed.[11]

At a Glance

Nickola v MIC General Insurance Company underscored that claimants under MCL 500.2006(4) fall into one of two categories: those who have a contractual relationship with an insurer, and those who have successfully sued someone who has a contractual relationship with an insurer.

The former can recover penalty interest regardless of whether their claim was reasonably in dispute, but the latter must show the absence of a reasonable dispute as to liability, and "that the refusal to pay was in bad faith."

Nickola moved underinsured motorist and uninsured motorist claims from the second category to the first, but nothing in the opinion alters the standards for third-party tort claimants to recover under MCL 500.2006(4).

The distinction between first-party and third-party claims

MCL 500.2006(4) "divides insurance claims 'not paid on a timely basis' into two categories."[12] Citing this statute, the United States Court of Appeals for the Sixth Circuit stated that

> [f]or cases where the claimant is the insured or an individual or entity directly entitled to benefits under the insured's contract of insurance, the interest rate is 12% per annum. However, for third party tort claimant[s], the interest rate is 12% per annum if the liability of the insurer for the claim is not reasonably in dispute, the insurer has refused payment in bad faith and the bad faith was determined by a court of law.[13] (Internal quotation marks omitted.)

The distinction is important because if "the claimant is the insured or an individual or entity directly entitled to benefits under the insured's contract of insurance, and benefits are not paid on a timely basis, the claimant is entitled to 12 percent interest, *irrespective of whether the claim is reasonably in dispute*."[14] (Emphasis added.)

In certain situations, third-party tort claimants may pursue a claim directly against a tortfeasor's insurer. However, a judgment against the insured is generally a precondition to any such claim. This is because MCL 500.3030 otherwise bars direct actions by an allegedly injured party against an alleged tortfeasor's insurance company. But the Michigan Court of Appeals previously decided that an action by the injured person against a tortfeasor's insurer could be brought once there has been a determination of liability in the underlying suit.[15] While that decision is not precedentially binding,[16] the Michigan Supreme Court later cited it as instructive in explaining that "an injured person's interest in the resolution of the policy coverage question stems from the availability of a postjudgment garnishment action against the insurer in which the coverage question would be litigated."[17]

Once the third party has standing as noted above, MCL 500.2006(4) only allows third-party tort claimants to recover 12 percent interest "if the liability of the insurer for the claim is not reasonably in dispute, the insurer has refused payment in bad faith and the bad faith was determined by a court of law."[18] Therefore, either the existence of a reasonable dispute or the absence of bad faith as determined by a court of law is fatal to third-party tort claimant's demand for 12 percent penalty interest.[19] Whether a claim is reasonably in dispute is a question of law for the court:[20]

> [W]hen there is no indication that the insurer acted unreasonably or with dilatory motive in denying the claim, the court should find that the claim is reasonably in dispute. A policy also might be reasonably in dispute when the insurer—in good faith—disputes its obligation, contests legitimate issues, and makes no effort to delay recovery of benefits.[21] (Internal quotation marks and citation omitted.)

For many years, the final sentence of MCL 500.2006(1) presented the bench and bar with a sort of "optical illusion."[22] Beginning with *Siller v Employers of Wausau*,[23] this sentence was read to expand the applicability of the "reasonably in dispute" exception to interest liability from its limited scope under subsection (4) ("third-party tort claimant[s]" only) to all claims, including contract claims.[24] But in *Yaldo v North Pointe Insurance Company*, the Court clarified that "[w]ith respect to collection of twelve percent interest" under MCL 500.2006(4), "reasonable dispute is applicable only when the claimant is a third-party tort claimant,"[25] and where the action is based "solely on contract…the insurance company can be penalized with twelve percent interest, even if the claim is reasonably in dispute."[26] Although some courts initially declined to follow this aspect of *Yaldo* as dicta,[27] the Court of Appeals subsequently adopted *Yaldo*'s reasoning and found that the "reasonably in dispute" language of

> MCL 500.2006(4) applies only to third-party tort claimants; if the claimant is the insured or an individual or entity directly entitled to benefits under the insured's contract of insurance, and benefits are not paid on a timely basis, the claimant is entitled to 12 percent interest, irrespective of whether the claim is reasonably in dispute.[28] (Internal quotation marks and citations omitted.)

The *Nickola* decision

Nickola had a lengthy procedural history; it arose from an April 2004 accident, and the Nickolas first filed suit in April 2005. The Nickolas were injured in a car accident caused by Roy Smith, whose no-fault insurance policy provided the minimum liability coverage allowed by law: $20,000 per person, up to $40,000 per accident. Smith's insurer settled with the plaintiffs and paid them the limits of Smith's policy. The plaintiffs then looked to their own insurer for underinsured motorist benefits, and after obtaining an arbitration award against MIC, the plaintiffs sought 12 percent penalty interest under the Uniform Trade Practices Act. The trial court declined to award penalty interest, ruling that the penalty interest clause did not apply because the UIM claim was reasonably in dispute.[29]

The Michigan Court of Appeals affirmed, finding that "while plaintiff is seeking UIM benefits that are provided under the policy, he is doing more than merely making a simple first-party claim…" and "for plaintiff to succeed on his UIM claim, he essentially has to allege a third-party tort claim against his own insurer…."[30] The insurer "stands in the shoes of the alleged tortfeasor, and plaintiff seeks benefits from defendant that arose from the alleged tortfeasor's liability."[31] The panel further explained:

> This third-party tort claim is different in nature from a typical claim for first-party benefits, as it will often require proof of the nature and extent of the injured person's injuries, the injured person's prognosis over time, and proof that the injuries have had an adverse effect on the injured person's ability to lead his or her normal life. In addition, such a third-party tort claim is designed to compensate a claimant for past and future pain and suffering and other economic and noneconomic losses rather than compensation for immediate expenses that are generally associated with a first-party claim. In other words, plaintiff's UIM claim is tied to a third-party tort claim for damages that, in many respects, is fundamentally different from a typical first-party claim.[32] (Internal quotation marks and citations omitted.)

But the Supreme Court reversed, finding that the claimants

> were parties to the insurance contract. The Nickolas chose to pay higher insurance premiums in order to obtain protection from underinsured motorists. The Nickolas were insureds, not third-party tort claimants. Therefore, the first sentence of MCL 500.2006(4) is applicable, and the "reasonably in dispute" language contained in the second sentence does not apply to plaintiff's claim for UIM benefits.
>
> The Court of Appeals…erroneously focused on the nature of a UIM claim….Yet the plain language of MCL 500.2006(4) distinguishes only the identity of the claimant, not the nature of the claim. The proofs required for a UIM claim do not transform "the insured" into a "third party tort claimant" when seeking to enforce the insured's own insurance contract. The insured by definition is a party to the insurance contract, not a third party. Simply because the Nickolas' UIM coverage requires a particular set of proofs in order to recover UIM benefits does not transform plaintiff's claim for benefits under the insurance policy into a tort claim. In sum, the Nickolas were insureds who made a claim for benefits under their policy of insurance….[33]

The Court also reiterated that "if the claimant is the insured and benefits are not paid on a timely basis, the claimant is entitled to 12% penalty interest per annum irrespective of whether the claim is reasonably in dispute."[34] Furthermore, an "insured making a claim under his or her own insurance policy for UIM benefits cannot be considered a third party tort claimant under MCL 500.2006(4)" per the plain language of the statute.[35] (Internal quotation marks omitted.)

Conclusion

The Michigan Supreme Court's *Nickola* opinion underscored the bench and bar's longtime understanding that claimants under MCL 500.2006(4) fall into one of two categories: those who have a contractual relationship with the defendant insurer (first parties) and those who have successfully sued someone who has a contractual relationship with the defendant insurer (third parties). The former can recover penalty interest regardless of whether their claim was reasonably in dispute, but the latter must show *the absence of* a reasonable dispute as to liability *and* "that the refusal to pay was in bad faith."[36] The only change *Nickola* caused was to move underinsured motorist and uninsured motorist claims from the second category to the first. Nothing in the opinion alters the standards for third-party tort claimants to recover under MCL 500.2006(4). A clearer understanding of what *Nickola* says (and does not say) about this issue can streamline settlement discussions, reduce unnecessary motion practice, and generally benefit both sides of the bar. ■

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ENDNOTES

1. McDermott, *Insurance Code § 2006(4) Interest on Delinquently Paid Claims: Recognizing the § 2006(1) Optical Illusion and Reconsidering the "Penalty" Label*, 79 Mich B J 822 (2000) <https://www.michbar.org/journal/article?articleID=102&volumeID=9&viewType=archive> (accessed April 14, 2018).
2. *Nickola v MIC Gen Ins Co*, 500 Mich 115; 894 NW2d 552 (2017).
3. *Id.* at ___; 894 NW2d at 558–559.
4. MCL 500.2001; *Insurance Code § 2006(4) Interest*, p 822.
5. MCL 500.2002; *Insurance Code § 2006(4) Interest*, p 822.
6. MCL 500.2003(1); *Insurance Code § 2006(4) Interest*, pp 822–823.
7. MCL 500.2038; *Insurance Code § 2006(4) Interest*, p 823.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Bowlers' Alley, Inc v Cincinnati Ins Co*, 122 F Supp 3d 675, 679; 122 F Supp 3d 675 (ED Mich 2015) and *Bd of Trustees of Michigan State Univ v Continental Cas Co*, 730 F Supp 1408, 1417 (WD Mich 1990).
12. *Stryker Corp v XL Ins Am*, 735 F3d 349, 359–360 (CA 6, 2012) (applying MCL 500.2006(4) in diversity).
13. *Id.*
14. *Nickola v MIC Gen Ins Co*, 312 Mich App 374, ___; 878 NW2d 480, 486 (2015), rev'd on other grounds, *Nickola*, 500 Mich at 115.
15. *Security Ins Co of Hartford v Daniels*, 70 Mich App 100; 245 NW2d 418 (1976).
16. The Michigan Court of Appeals is not bound to follow its own published decisions issued before November 1, 1990. MCR 7.215(J)(1).
17. *Allstate Ins Co v Hayes*, 442 Mich 56, 69 n 13; 499 NW2d 743 (1993).
18. *Stryker*, 735 F3d at 360. See also *Nickola*, 312 Mich App at ___; 878 NW2d at 487.
19. *Medley v Canady*, 126 Mich App 739, 743; 337 NW2d 909 (1983).
20. *Federal Ins Co v Hartford Steam Boiler Inspection & Ins Co*, 415 F3d 487, 499–500 (CA 6, 2005) (applying MCL 500.2006(4) in diversity).
21. *Id.*
22. *Insurance Code § 2006(4) Interest*, 79 Mich B J at 823.
23. *Siller v Employers of Wausau*, 123 Mich App 140, 143–144; 333 NW2d 197 (1983).
24. *Insurance Code § 2006(4) Interest*, 79 Mich B J at 823.
25. *Yaldo v North Pointe Ins Co*, 457 Mich 341, 349; 578 NW2d 274 (1998).
26. *Id.* at 348 n 4.
27. *Griswold Props, LLC v Lexington Ins Co*, 275 Mich App 543, 547; 740 NW2d 659, 663 (2007), citing *Arco Industries Corp v American Motorists Ins Co*, 233 Mich App 143; 594 NW2d 74 (1998).
28. *Griswold Properties, LLC v Lexington Ins Co*, 276 Mich App 551, 566; 741 NW2d 549 (2007).
29. *Nickola*, 312 Mich App at ___; 878 NW2d at 482–483.
30. *Id.* at 487.
31. *Id.*
32. *Id.*
33. *Nickola*, 500 Mich at ___; 894 NW2d at 558–559.
34. *Id.* at 561.
35. *Id.* at 553.
36. *Medley*, 126 Mich App at 743. See also *Trustees of Michigan State Univ*, 730 F Supp at 1417.