Michigan Recognizes Claims for Bad-Faith Insurance Practices

but the burden is high and there are many limitations

By Adam Kutinsky

Since the Michigan Supreme Court issued *Kewin v Massachusetts Mut Life Ins Co* in 1980,[1] the judiciary has steadily narrowed the basis on which individuals and business may bring claims for bad-faith practices against insurance carriers. This article discusses those limitations and considers the remedies available to an aggrieved party.

Insurance is a tool of risk management

The law recognizes that, no matter how presented, when a claim is denied, there will be a negative reaction by the policyholder.[2] This holds true in practice, even when the denial is correct and the policy language is clear and understandable, since disappointment is a natural response to an unexpected financial burden. Because the role of an insurance agent varies based on the expectations of the insured and other factors, each insured should choose his or her agent deliberately. The adage "jack of all trades, master of none" recognizes the importance of specialization, which applies to insurance as it does to all professions.

Theodore "Theo" Nittis and David Kramer, both former practicing attorneys, follow the specialization model at their agency, Gemini Risk Partners, LLC, which concentrates on professional liability insurance for attorneys. As Nittis explained during a recent discussion with him, there are areas of exposure that cannot be eliminated by an insurance policy: "A good insurance broker can and will help an insured client understand the high points of their coverage, but it's impossible to escape all of the gray areas."

Dealing with exposure to loss should be viewed through a lens of risk management. Insurance (or risk transfer) should be the primary, but not sole, approach to minimizing and eliminating risk. At Nittis's agency, the relationship with each insured begins with risk management before binding coverage and continues through the coverage term, including claims handling.

"I counsel clients to look at the reservation of rights letter as an advanced roadmap for the insured or its coverage counsel, so that they can understand how the insurer is approaching the claim and what rules the company believes apply to the particular facts," Nittis told me.

Unbeknown to many people, insureds are required by law to read their policies within a reasonable time of receipt and contact their agents or carriers with questions.[3] Failure to do so could weaken a claim brought later against the agent or carrier. Of course, it would be ideal if every policyholder took the time to review his or her insurance policy and ask the carrier or agent for an explanation of convoluted provisions. Unfortunately, in many cases, an insured opens the envelope containing the policy and files it away until a claim arises.

Valid denial of coverage versus bad-faith claims practices

If a person is negatively affected by a *valid* denial, it is not unreasonable to expect greater distress if the insurance company *wrongfully* denies coverage, even if a mistake was made in good faith. Going further, if a policyholder hires an attorney

and succeeds in a lawsuit seeking insurance coverage, he or she usually develops a reasonable expectation of recompense. But Michigan follows the American rule,[4] which provides that attorney fees are only recoverable when expressly authorized by a statute, court rule, or a recognized exception, such as a prevailing party provision in the contract between the parties.[5]

Finally, there is "bad faith," which generally means the insurance company arbitrarily, recklessly, or intentionally placed its own interest ahead of its insured at some point in the relationship, usually during adjustment of a claim.[6] Even when malice is proven, punitive damages are not permitted,[7] which is the general law in our state.[8] However, exemplary damages are permissible as compensation for emotional pain and suffering under certain limited circumstances. "They are awardable where the defendant commits a voluntary act which inspires feelings of humiliation, outrage, and indignity. The conduct must be malicious or so willful and wanton as to demonstrate a reckless disregard of the plaintiff's rights."[9]

Experience leads to the conclusion that the American rule has a direct chilling effect on lawsuits initiated by insureds involved in coverage disputes. In particular, insureds have very few options if they can't afford an attorney and the amount at issue is insufficient to justify a contingency fee.

Under limited circumstances, Michigan law provides for awarding attorney fees and costs to claimants who succeed in litigation; examples include the Michigan No-Fault Act[10] and the Michigan Consumer Protection Act (MCPA).[11] The MCPA only applies to consumer transactions and is therefore inapplicable to disputes arising from commercial insurance policies.[12] If an insured alleges misconduct related to a consumer-based "personal lines" policy, he or she must not only prove the carrier violated the MCPA, but is also required to establish that the conduct was unlawful under Chapter 20 of the Insurance Code.[13]

AT A GLANCE

The law recognizes that no matter how presented, when a claim is denied, there will be a negative reaction by the policyholder. This holds true in practice, even when the denial is correct and the policy language is clear and understandable.

Michigan common law defines bad faith as "arbitrary, reckless, indifferent, or intentional actions or disregard of the interests of the person owed a duty"; however, in practice, bad faith presents itself as the insurance company placing its own interest ahead of its insured.

Insurance policies are governed by contract law, and generally, attorney fees are not recoverable by a policyholder or other person entitled to benefits unless expressly authorized by statute, court rule, or other legally recognized exception.

No extra-contractual damages for commercial contracts

The Michigan Supreme Court did away with the "adhesion contract doctrine" in 2005[14] and has largely limited an individual's right to recover extra-contractual damages for bad-faith breach of "personal" contracts, defined as related to "rights we cherish, dignities we respect, emotions recognized by all as both sacred and personal."[15]

The seminal Michigan Supreme Court case on damages awarded for bad faith is *Kewin v Massachusetts Life Ins Co*. The definition of bad faith under Michigan law is "arbitrary, reckless, indifferent, or intentional actions or disregard of the interests of the person owed a duty."[16] *Kewin* serves as precedent for the limits imposed on damages awarded to a plaintiff who successfully proves an insurer's conduct meets this definition. Contrary to common belief, *Kewin* did not rule out the possibility of recovering exemplary damages in every case of breach of contract:

> We hold that, absent allegation and proof of tortious conduct existing independent of the breach, see, e.g., *Harbaugh v Citizens Telephone Co*, 190 Mich 421; 157 NW 32 (1916), exemplary damages may not be awarded in common-law actions brought for breach of a *commercial* contract.[17] (Emphasis added.)

The *Kewin* Court qualified its ruling as applying to *commercial* contracts. It determined that a disability policy was the culmination of a financial transaction and, thus, a commercial contract, not personal, the breach of which results in no more than its monetary value.[18] The *Kewin* opinion is commonly cited as barring recovering of exemplary damages for breach of *any* contract.[19] But that skips the step of determining whether mental distress damages were within the parties' contemplation at the time the contract was made, i.e., whether the insurance policy is a personal contract for which exemplary damages may be awarded.[20]

After *Kewin*, the Court of Appeals issued *Shikany v Blue Cross & Blue Shield of Michigan*,[21] which found a health insurance policy to be a commercial contract as well. However, the Court still recognized the personal contract exception:

> Here, the contract between plaintiff and defendant provided for the payment of certain medical expenses, a financial arrangement capable of accurate monetary recompense for any breach. We find that the hospitalization insurance contract is

> unlike the contracts in *Stewart* and *Miholevich* in that the damages resulting from the loss of a child or a deprivation of personal liberty are not capable of being compensated by reference to the monetary value of the contract alone. Furthermore, both those contracts involved special personal or sacred rights where mental anguish and distress were likely results of the breach and were not only within the contemplation of the parties but were "an integral and inseparable part of" the contract.[22]

Why has the judiciary moved away from first determining whether a policy's subject matter is personal or commercial *before* barring extra-contractual damages? One answer may be that *Kewin* involved a disability policy and *Shikany* involved health insurance, both of which are so closely linked to "rights we cherish and dignities we respect" that finding both to be commercial contracts implicitly eradicated the distinction of personal versus commercial contracts altogether.

Whatever the reason, since *Kewin* was published, language stating "we hold that a disability income protection insurance policy contract is a commercial contract, the mere breach of which does not give rise to a right to recover damages for mental distress"[23] morphed into the rule that mere breach of an insurance policy does not give rise to mental distress damages. Then, in 1994, the Michigan Court of Appeals extended the rule to bad faith, declaring, "Failure to pay a contractual obligation does not amount to outrageous conduct, even if it is willful or in bad faith."[24]

Kewin is now commonly cited as the basis for the rule that Michigan does not recognize an independent cause of action for bad-faith breach of an insurance policy,[25] even though it did not rule as such. For its part, the legislature enacted the Uniform Trade Practices Act, which defines, prohibits, and penalizes insurance company conduct that amounts to bad faith.[26] And although insureds may recover penalty interest under the act, the Michigan Court of Appeals found it did not create a separate private cause of action against insurers.[27]

Evaluating whether bad-faith conduct occurred during the claims process begins with establishing that the claim was denied wrongfully and then determining if the conduct of the insurance company fell outside acceptable claims handling. If coverage exists for a denied claim but there was no bad faith, the insured's relief is straightforward—he or she receives the benefits under the policy, plus interest.[28] As mentioned previously, attorney fees are not recoverable absent a contractual provision, another exception, or basis in court rule or statute.[29] Attorney fees are provided to prevailing insureds under the automobile no-fault law, but not to successful insureds in other property-casualty insurance disputes.[30]

If a claimant is interested in pursuing a claim based on bad-faith conduct, the most important factors to consider are manner and motive. Bad faith can be subtle (placing the interest of the insurance company ahead of the interest of the insured)[31] or it can be obvious (when an adjuster uses the insurer's right to investigate as a means of harassment).[32]

Don't call the conduct "bad faith"

Considering *Kewin* and its progeny, what does proving bad faith add to an insured's recovery? The answer is that bad-faith conduct may form the basis of extra-contractual damages, but the claimant is better served by not using the term "bad faith."

First-party claims

An insured aggrieved by conduct of an insurance company may consider claims for intentional infliction of emotional distress[33] or negligent infliction of emotional distress.[34] While there is no tort for bad-faith denial of insurance benefits, the emotional-distress torts make the underlying bad-faith conduct actionable and support damages beyond compensatory.[35] However, the policyholder should appreciate the heightened burden imposed on emotional distress claims. If it were recognized, an independent tort of bad faith would carry a "preponderance of the evidence" burden, with a standard of "arbitrary, reckless, indifferent, or intentional disregard."[36]

Conversely, claims of intentional or negligent infliction of emotional distress require proof of "extreme or outrageous conduct" resulting in "extreme emotional distress."[37] Therefore, the insurer's conduct must exceed ordinary "threats, insults or indignities," but if evidence of insurance company conduct and the resulting distress is legally sufficient, the insured is entitled to an award of extra-contractual damages.[38]

Other strategies make use of bad-faith conduct without bringing an independent claim. Take, for example, *Isagholian v Transamerica Ins Co*, which involved a plaintiff who sued his homeowners insurance company for breach of contract and a separate claim for "bad-faith dealings." The claim for bad-faith dealings was not actionable, but the Court permitted the jury to hear evidence of the insurer's conduct, stating "[t]he good faith of both parties was integral to this action."[39] Although the insured did not expand the damages available to him, he strengthened the claim that went to the jury.

Evidence of bad faith has also been used to form the basis of fraud and related misrepresentation claims.[40] Note that the burden for proving fraud is also heightened to clear-and-convincing evidence and must be pled with specificity.[41] Finally, as previously discussed, the aggrieved insured may consider whether the alleged conduct violates the MCPA.[42]

Third-party claims

Up to this point, we have focused on first-party disputes; however, there is a separate framework for determining bad faith when third-party tort claimants are involved. A recognized claim for bad faith arises when an insurance company refuses to settle a lawsuit that goes to trial and a verdict returns in excess of the policy limits.

Bad-faith failure to settle within policy limits is an exception to the general rule against awarding extra-contractual

damages. The law recognizes the same definition of bad faith as first-party coverage, but when the insurance in dispute protects against third-party claims, additional remedies exist. The Michigan Supreme Court identified 12 non-exhaustive indicators of bad faith to consider when evaluating the conduct of an insurance company.[43]

As mentioned, the Uniform Trade Practices Act recognizes, defines, and penalizes bad faith. The insured cannot bring a private cause of action,[44] but may be awarded statutory interest on late or withheld insurance benefits at 12 percent per annum. Interest begins to accrue 60 days following submission of the claimant's satisfactory proof of loss.

Griswold Props, LLC v Lexington Ins Co clarified the distinction between awarding first-party and third-party penalty interest.[45] The *Griswold* Court interpreted the act to mandate payment of 12 percent interest on first-party claims that are not paid on a timely basis, without regard to the reason for withholding payment. Conversely, insurance companies have the right to withhold benefits without fear of penalty interest if they can prove the third-party claim was reasonably in dispute.[46]

Conclusion

Bad-faith breach of an insurance contract, whether alleged as a tort or as part of a breach of contract action, is limited under Michigan law. Nevertheless, the doctrine of bad faith is not entirely outlawed and, depending on the particular policy of insurance and conduct of the insurer, an actionable claim or claims may be brought by an insured or other party entitled to benefits under Michigan law. Understanding how to navigate the framework governing bad faith is essential when drafting a complaint under Michigan law. ■

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ENDNOTES

1. *Kewin v Massachusetts Mut Life Ins Co*, 409 Mich 401; 295 NW2d 50 (1980).
2. *Id.* at 416.
3. *Harts v Farmers Ins Exch*, 461 Mich 1, 8 n 4; 597 NW2d 47 (1999).
4. *Burnside v State Farm Fire & Cas Co*, 208 Mich App 422, 426–427; 528 NW2d 749 (1995).
5. *Id.* at 429–431.
6. *In re Green Charitable Trust*, 172 Mich App 298, 315; 431 NW2d 492 (1988).
7. *McChesney v Wilson*, 132 Mich 252, 258; 93 NW 627 (1903).
8. *Hicks v Ottewell*, 174 Mich App 750, 756; 436 NW2d 453 (1989).
9. *Jackson Printing Co v Mitan*, 169 Mich App 334, 341; 425 NW2d 791 (1988) and *Bailey v Graves*, 411 Mich 510, 515; 309 NW2d 166 (1981).
10. MCL 500.3101 *et seq.*
11. MCL 445.901 *et seq.*
12. See MCL 445.902(1)(g) (definition of "trade or commerce").
13. *Cromer v Safeco Ins Co of America*, unpublished opinion of the United States District Court for the Eastern District of Michigan, issued April 14, 2010 (Case No. 2:09-cv-13716). See also *McLiechey v Bristol West Ins Co*, 474 F3d 897, 904 (CA 6, 2007).
14. *Rory v Continental Ins Co*, 473 Mich 457; 703 NW2d 23 (2005).
15. *Butler v Detroit Auto Inter-Insurance Exch*, 121 Mich App 727, 732; 329 NW2d 781 (1982), citing *Stewart v Rudner*, 349 Mich 459; 84 NW2d 816 (1957).
16. *Commercial Union Ins Co v Liberty Mut Ins Co*, 426 Mich 127, 136; 393 NW2d 161 (1986).
17. *Kewin*, 409 Mich at 421.
18. *Id.*
19. Peterson Williams, *Michigan Insurance Law and Practice* (ICLE, 2018), Chapter 2, § 2.35 ("Exemplary damages are not recoverable for breach of a contract 'absent allegation and proof of tortuous [sic] conduct existing independent of the breach.'").
20. *Kewin*, 409 Mich at 421.
21. *Shikany v Blue Cross & Blue Shield of Mich*, 134 Mich App 603; 350 NW2d 910 (1984).
22. *Id.* at 610, citing *Stewart*, 349 Mich at 471.
23. *Kewin*, 409 Mich at 419.
24. *Taylor v Blue Cross & Blue Shield of Mich*, 205 Mich App 644, 657; 517 NW2d 864 (1994).
25. *Id.*
26. MCL 500.2001 *et seq.*
27. *Safie Enterprises, Inc v Nationwide Mut Fire Ins Co*, 146 Mich App 483; 381 NW2d 747 (1985).
28. *Isagholian v Transamerica Ins Corp*, 208 Mich App 9; 527 NW2d 13 (1994).
29. *Burnside*, 208 Mich App at 426–427. ("In Michigan, it is well-settled that the recovery of attorney fees is governed by the 'American rule.'" *Matras v Amoco Oil Co*, 424 Mich 675; 385 NW2d 586 (1986). Under the American rule, attorney fees are generally not allowed, as either costs or damages, unless recovery is expressly authorized by statute, court rule, or a recognized exception. *Clute v General Accident Assurance Co of Canada*, 177 Mich App 411, 417; 442 NW2d 689 (1989). See also *Brooks v Rose*, 191 Mich App 565, 575; 478 NW2d 731 (1991); *State Farm Mut Auto Ins Co v Allen*, 50 Mich App 71, 74; 212 NW2d 821 (1973). Exceptions to the general rule are construed narrowly. *Rose, supra*; *Scott v Hurd-Corrigan Moving & Storage Co, Inc*, 103 Mich App 322, 347; 302 NW2d 867 (1981).)
30. MCL 500.3101 *et seq.*
31. *Commercial Union*, 426 Mich at 137 ("If the insurer is motivated by selfish purpose or by a desire to protect its own interests at the expense of its insured's interest, bad faith exists, even though the insurer's actions were not actually dishonest or fraudulent," citing *Valentine v Liberty Mut Ins Co*, 620 F2d 583 (CA 6, 1980) and *Shearer v Reed*, 286 Pa Super 188; 428 A2d 635 (1981)).
32. *Isagholian*, 208 Mich App at 11.
33. *McCahill v Commercial Union Ins Co*, 179 Mich App 761; 446 NW2d 579 (1989).
34. *Auto Club Ins Assoc v Hardiman*, 228 Mich App 470; 579 NW2d 115 (1998).
35. *McCahill*, 179 Mich App at 761 (the Court of Appeals upheld a $100,000 jury verdict against an insurance company for intentional infliction of emotional distress upon its insured).
36. *Commercial Union*, 426 Mich at 136.
37. *Roberts v Auto-Owners Ins Co*, 422 Mich 594; 374 NW2d 905 (1985).
38. *Id.* at 603.
39. *Isagholian*, 208 Mich App at 12.
40. *Kassab v Mich Basic Prop Ins Assoc*, 441 Mich 433; 491 NW2d 545 (1992).
41. *Id.* at 442.
42. MCL 445.903.
43. *Commercial Union*, 426 Mich at 138.
44. *Safie Enterprises*, 146 Mich App at 494.
45. *Griswold Props v Lexington Ins Co*, 276 Mich App 551; 741 NW2d 549 (2007).
46. *Yaldo v North Pointe Ins Co*, 457 Mich 341; 578 NW2d 274 (1998).