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Liability System

THE TOPIC

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Litigiousness has become a societal problem in the United States.

U.S. consumers pay directly for the frequency and high cost of going to court through higher liability insurance premiums because liability insurance rates reflect what insurance companies pay out for their policyholders' legal defense and any judgments against them. Consumers also pay indirectly in higher prices for goods and services since businesses pass on to consumers the expenses they incur in protecting themselves against lawsuits, including the cost of insurance.

Tort law is the basis for the U.S. liability system. It is the body of law governing negligence, intentional interference and other wrongful acts that result in injury or damage for which a civil action can be brought, with the exception of breach of contract, which is covered by contract law.

Liability insurance distributes the costs of the liability, or tort, system. The tort system reflects the values of society, which through the courts and the legislative process, decides which injuries should be compensated, in what circumstances and in what amounts.

Beginning in the 1980s, in an effort to reduce litigation costs, business groups and others mounted a campaign to reform tort law. Most reforms have taken place on the state level, and during the last decade all but a handful of states passed significant tort law reforms. However, some have been overturned by the courts.

RECENT DEVELOPMENTS

- **Bad Faith Lawsuits:** An August 2014 Insurance Research Council (IRC) study suggests that third-party bad faith lawsuits may have resulted in more than $800 million in additional auto liability claim payments in 2013, or an extra $79 in claims costs for every insured vehicle in the state. The IRC report, ?Third-Party Bad Faith in Florida?s Auto Insurance System,? says that bodily injury claim frequency in Florida increased dramatically from 1995 to 2013 and that the average claim payment per vehicle jumped by 68 percent during that period. Other large no-fault states that do not allow third-party bad-faith lawsuits against insurers, such as New Jersey, New York and Pennsylvania, saw significant declines in liability claim frequency and much smaller increases or even declines in claim payments per insured vehicle.
- Over the past few years, a number of states have considered bad faith proposals. Bad-faith lawsuits allege bad faith in the settlement of a claim. Bills were introduced in Oregon and New Jersey in 2013. Several states have enacted laws that allow first-party bad-faith lawsuits against insurers, including Washington (2007), Maryland (2007) and Minnesota (2008), and many additional states and the District of Columbia considered such legislation. (A first-party claim is one filed by the policyholder under the policyholder?s insurance policy, see also

Background section.)

- According to a study by the Insurance Research Council (IRC), ?The Impact of Third-Party Bad-Faith Reforms on Automobile Liability Costs in West Virginia,? published in October 2011, reforms adopted by the West Virginia State Legislature in 2005 reduced insurance costs by about $200 million over the five-year period following the reforms? enactment. The legislation eliminated the right of third-party insurance claimants to file lawsuits against the other person?s insurance company when they believed the company had treated them unfairly. Instead of turning to the courts, dissatisfied claimants can now file their complaints with the insurance commissioner, who is responsible for investigating whether an insurer has violated the state?s Unfair Trade Practices Act and imposing the appropriate fines and penalties.
- Another IRC study published in March 2011 entitled ?The Impact of First-Party Bad-Faith Litigation on Key Insurance Trends in Washington State? found a significant surge in homeowners insurance claim payments from 2006 to 2009, which it attributes to Washington?s enactment of the Insurance Fair Conduct Act in December 2007. The Act, R-67, simplified the process for dissatisfied claimants to file bad-faith lawsuits against insurers so that Washington State now has the lowest standard in the country for the filing of first-party bad faith lawsuits. According to the study?s findings, the measure could have caused as much as $190 million in higher claim costs for the years 2008 and 2009. Although average claim payments increased in other states too, the average increase in Washington was 17 percentage points greater than in the control group states.
- Under R-67, insurers can be sued for three times the amount of damages, plus attorneys? fees. The threat of costly litigation and treble damages pushes insurers to settle more questionable claims without a full investigation and to settle for higher amounts to reduce the risk of punitive damages.
- **Higher Caps on Noneconomic Damages Awards.** In Kansas the cap on noneconomic damages in personal injury actions has been increased from $250,000 to $350,000 in three increments over the next eight years, reaching the final figure on or after July 1, 2022. The law, SB 311, took effect in July 2014. Some of the impetus for the increase was due to comments made by members of the state?s Supreme Court in October 2012, when it upheld the law limiting noneconomic damages to $250,000 and the right of the legislature to impose limits but suggested that a future challenge might be successful since the amount had not been raised since the cap was enacted in 1988. SB 311 also amended statutes on expert witness testimony and the qualifications of experts to bring them in line with federal Daubert standards, see Background section on Scientific Evidence.
- **Medical Malpractice Ballot Initiative in California:** An initiative that would raise the cap on medical malpractice noneconomic damage awards will be on the ballot in California in November. The current cap of $250,000 has been in effect since 1975. The measure?s formal title is ?Drug and Alcohol Testing for Doctors,? referring to a provision that would require random testing of physicians, but the real focus of the initiative is on the pain and suffering (noneconomic damages) part of the question. The limit on noneconomic damages, which does not apply to nonmedical malpractice cases, has been credited with helping to stabilize the price of medical malpractice insurance premiums after a period in the mid-1970s when doctors threatened to leave the state because of soaring rates. The initiative would raise the current $250,000 cap to $1.1 million to account for inflation since the limit was imposed. Opponents say that the increase will push up the cost of medical malpractice coverage.
- **Caps Upheld:** Mississippi?s $1 million cap on noneconomic damages was upheld at the end of February 2013 in an auto accident case where the jury did not specify how much of the award was for economic damages and how much for noneconomic damages, such as pain and suffering.

- **Caps Overturned:** In a ruling in June 2013 the Oklahoma State Supreme Court found that the state?s 2009 Tort Reform Act was unconstitutional in that it violated the state?s single subject rule. The law included some 90 different reforms.
- **Shareholder Lawsuits:** Total settlement dollars for securities class-actions rose 46 percent in 2013, and the number of settlements also increased, according to Cornerstone Research?s latest study. Six mega-settlements (defined as those above $100 million) accounted for 84 percent of all settlement dollars, the second highest proportion in the past decade, researchers said. The largest settlements were associated with either pharmaceutical companies or financial institutions involved in the subprime credit crisis allegations, Cornerstone said. The 2013 median estimated damages, a key measure of investor losses, declined 48 percent from 2012 and most likely contributed to the substantially lower median settlement amount of $6.5 million in 2013.
- According to NERA Economic Consulting?s ?Recent Trends in Securities Class Action Litigation: 2013 Full Year Review? report, released in January 2014, the number of securities class-action filings rose by 10 percent to 234 from 213, compared with the average over the past five years of 224. Average amounts for ?usual? settlements (those under $1 billion and excluding two specific classes of settlements) broke earlier records, hitting $55 million, an increase of 53 percent over 2012 and a 31 percent increase over the previous high in 2009. The median settlement was $9.1 million, a 26 percent decrease from 2012. NERA says large settlements were larger, driving the average settlement amount to its record high, but there were numerous small settlements, which pushed down the median amount. Nine settlements exceeded $100 million.

- **Reducing Medical Malpractice Lawsuits:** A number of proposals are being tried in an effort to reduce the cost of the medical malpractice system. In March 2013 Oregon adopted legislation that would set up a system of out-of-court mediation to try to avoid lengthy and costly lawsuits. In Massachusetts healthcare professionals can now disclose unanticipated adverse outcome to patients, apologize and offer fair compensation. In New Hampshire a healthcare provider or its insurer can make an early settlement offer to an injured patient considering a medical malpractice lawsuit.
- New York State received a $3 million grant in 2010 from the Department of Health and Human Services (HHS) to conduct a three-year pilot program aimed at promoting patient safety and achieving rapid settlement of medical malpractice cases wherever possible, thus reducing ?transaction costs,? which are estimated to make up about 60 percent of total costs.
- Five New York City hospitals participated in the study: four initiated safety initiatives in obstetrics and one in general surgery. The grant called for each hospital to establish an early disclosure program through which patients are notified of medical errors and offered compensation and for the state to set up a special health court with specially trained judges to handle negotiations in cases that are not settled and lead to the filing of lawsuits. Of the 20 programs funded by HHS under a federal program to encourage states to design demonstration projects that would lead to reduced costs, New York?s was the only one awarded to a court system. The program which went into effect in 2011, is based on a model created by a New York City judge that is used for all medical malpractice cases involving the Health and Hospital Corporation, which runs New York City?s municipal hospitals. The ?judge-directed negotiations? program has produced savings of up to $50 million annually in defense costs and indemnity payments.

BACKGROUND

Liability insurance pays for amounts paid to the claimant as compensation for injury and for the costs

of defending the policyholder in court. The American civil liability system cost $25.7 billion in 2008 in direct costs (the last year for which there are data) and many billions more in indirect costs. Tort costs accounted for about 1.8 percent of the nation?s gross domestic product, down from a high of about 2.2 percent in the years 2002-2004 but up from 0.6 percent in 1950, according to data from Towers Perrin, an actuarial consulting firm. Looking at the data another way, tort costs equaled $838 per U.S. citizen in 2008 compared with $12 in 1950.

An earlier Tillinghast study suggests that the tort system is highly inefficient, returning less than 50 cents on the dollar to claimants. Breaking down costs, Tillinghast found that an estimated 22 cents go to litigants for their actual (economic) losses and 24 cents to compensate for pain and suffering (noneconomic losses). Of the remaining 54 cents, 19 cents pays for claimants; lawyers, 14 cents for defense costs and 21 cents for administrative costs associated with the settlement of tort claims.

There are signs that we have reached the limit of what people believe we can afford to pay for compensation, not only in terms of the number and cost of awards but also in terms of the overall impact of excessive litigation. Many legal experts believe the American civil justice system is in need of reform. Such critics cite the number of lawsuits, the size of some awards and the rise over time in the number of class action lawsuits.

Lawsuits represent only a small portion of total liability claims, however. Only 2 percent of such claims are settled by verdict and only one-third of claims become lawsuits. Nevertheless, lawsuit verdicts are important because they influence the damage amount sought by plaintiffs and the size of out of court settlements.

The law is constantly changing in response to societal needs and perceptions of justice. New legal theories or modifications of existing tort law are continually being developed. Fifty years ago reformers worked to rectify what they believed was a bias in the tort system toward defendants and business interests, making it easier for plaintiffs to receive compensation for their injuries. Now reformers are working to reduce what appears to many to be abuse of the tort system by those representing plaintiffs. Supporters of tort reform were successful in the 1980s and early 1990s in getting major legislation enacted in many states. They also set in motion a more conservative attitude toward jury awards among the public.

Changes in Legal Doctrine and Other Trends: In most states prior to the 1960s, an injured person would be compensated only if the defendant was wholly responsible for the plaintiff?s injuries. As societal values changed, the doctrine of contributory negligence, under which plaintiff?s? claims would be denied if they contributed to the injury through their own actions, gave way to the doctrine of comparative negligence, which requires damages to be apportioned based on the degree of fault. This change gradually occurred in all but a handful of states.

There are two major categories of comparative negligence: pure and modified. Under the pure form, damages are reduced by the amount of the plaintiff?s negligence. The modified form is divided into three types: the "less than" rule or 49 percent, i.e., plaintiffs may receive damages if their negligence is not as great as the defendant?s; the "not greater than" rule or 50 percent system, i.e., recovery is barred if the plaintiff?s negligence is greater than the defendant?s; and the "slight versus gross" system, where the plaintiff may receive damages if the plaintiff?s negligence was slight in comparison to the defendant?s negligence.

Changes in the area of municipal liability brought about a large increase in the number of suits. Prior to the 1960s, in all but a few states public entities were not liable for civil wrongs and were protected against personal injury actions by a common law doctrine known as sovereign or governmental immunity. However, as state and local governments began to provide a growing array of services that

were also available in the private sector, from paving roads to managing recreational programs, the idea that governments were not subject to the same legal standards as private citizens and corporations carrying out the same activities offended the public?s sense of justice. Today government entities can be sued for false arrest, failure to arrest and failure to meet certain standards of care in almost every aspect of governmental activity.

Class Actions: Class actions settle in a single lawsuit the rights and liabilities of people who have similar claims. In order for claims to be consolidated in a single suit, the court must certify that the case meets Federal Rule of Civil Procedure 23, which sets out the requirements for claims to be eligible for class-action status.

Several factors distinguish class actions from other kinds of lawsuits such as automobile accident cases. In class actions, there are a large numbers of claimants who have suffered a common set of injuries incurred in the same or similar circumstances and most plaintiffs are represented by a small number of law firms, each of which may represent hundreds or thousands of claimants.

There are many different types of class actions, including shareholder and civil rights suits. In the 1980s and 1990s, lawyers began to use the class-action lawsuit to settle what became known as "mass torts"?personal injury cases involving medical devices, toxic substances such as asbestos, and new pharmaceutical products where many people sustained injuries from the same product. Although class actions have been certified in many personal injury cases, the lawyers and judges who wrote the federal class-action rule adopted in 1966 said that a "mass accident" is ordinarily not appropriate for a class action because of the conflicts among state laws and the differences in the claimants? injuries. Nevertheless, they said, a class action may be brought if the legal and factual issues in common outweigh the differences. As a practical matter, some judges certify mass torts because the individual cases would overwhelm the courts.

Although this kind of litigation is not new, the number of class actions appears to have grown in recent years. It is difficult to ascertain the number of cases because state courts, where the majority are filed, publish little data on this subject. From the viewpoint of the claimant, class actions have some advantages. First, they prevent the defendant?s assets from being depleted by the first judgment so that little remains for any subsequent claimant. Second, they allow a group of injured citizens to obtain redress without incurring huge legal fees. However, some public policy observers believe that the publicity surrounding class actions is beginning to lead to abuse of the legal system. At their worst, critics say, class actions can amount to legalized blackmail for defendants; a sell-out for claimants, who may receive little compensation for their injuries; and a get-rich scheme for lawyers who receive a percentage of the total settlement.

Restoring the Balance between Plaintiffs and Defendants: Over time there have been swings in the balance between plaintiffs? and defendant?s rights. It became increasingly apparent in the 1980s that in the attempt to make up for past imbalances the law had swung too far in favor of plaintiffs. For example, in most states, under the doctrine of joint and several liability, if two or more persons have a part in causing a plaintiff?s injury, they are joint wrongdoers and are jointly and severally liable. They are, therefore, responsible for the whole amount a plaintiff may recover for his or her injuries, regardless of each defendant?s share of fault. The change to comparative negligence in the 1960s and 1970s greatly affected the equity of the joint and several liability rule. It meant that a plaintiff who was 45 percent at fault may collect the whole award payment from a defendant much less to blame for the accident than the plaintiff himself. In such cases, defendants with "deep pockets"?corporations and municipalities seen as having an almost unlimited power to raise money through taxes?often ended up footing the bill. In the mid-1980s states began to modify this rule to make the tort system more equitable. Some abolished joint and several liability altogether, making each party responsible for its share of blame. Some abolished it for defendants 50 percent or less liable or restricted its application.

Members of Congress have also taken up tort reform fights in an attempt to create more uniform liability laws and extend successful measures to all jurisdictions. Over the years pro-reform lawmakers have pushed for products liability, class-action, medical malpractice liability and asbestos reform, among others.

There is also the issue of punitive damages. People who bring suits may ask for punitive damages in addition to compensation. Intended to "punish" a defendant?s outrageous conduct, punitive damages can amount to millions of dollars, although many initially large awards are significantly reduced on appeal. Many believe that the prospect of receiving a big "bonus" brings into court cases that otherwise could be settled without a judge or jury, especially where the dispute is relatively minor. Some argue that if serious wrongs have been committed as opposed to common negligence, wrongdoers should be punished by criminal, not civil, courts. Others believe that punitive damages belong within the domain of civil law but that the fully compensated winning party should not be the beneficiary (the punitive award should go to the state or to charity) and the size of punitive damages should bear some relationship to the award for compensatory damages. (Since the 1980s a small minority of states has passed legislation that sets aside a percentage of punitive damage awards for the state, but in a few states these laws have been repealed.) And in products liability suits, a single defendant should not be "punished" over and over again for the same defect each time a new case goes to trial.

One problem caused by multiple punitive damage awards is that the first few plaintiffs to bring suit may receive large awards, leaving the defendant with barely sufficient funds to pay subsequent plaintiffs? out-of-pocket expenses. Fear of using up all available funds to pay punitive damage awards was one of the reasons Manville Corporation, the asbestos manufacturer; A.H. Robins, maker of the Dalkon Shield contraceptive device; and Dow Corning, maker of silicone breast implants, filed for bankruptcy.

The issue of punitive damages and their constitutionality has been brought before the U.S. Supreme Court. In the first case designed to guide lower courts on the imposition of punitive damage awards, Pacific Mutual Life Insurance Co. v. Haslip in 1991, the court ruled that the punitive damages awarded did not violate due process. The court stated that the judicial procedures, designed to ensure that punitive damages were not egregiously out of proportion to compensatory damages, were followed in the case. Punitive damages were four times greater than compensatory damages, which the court acknowledged were high, but they did not cross the line into the area of constitutional impropriety, it said.

More recently, the Court moved closer to determining when punitive damages may be excessive in a

State Farm case involving a bad faith award. The ruling was handed down in April 2003. However, the high court has yet to rule in a case that involves physical harm. In the State Farm case, State Farm v. Campbell, the high court overturned a $145 million punitive damage award (145 times the compensatory damage verdict) imposed by a Utah jury. The court ruled that juries should generally not be allowed to consider a defendant?s wealth when setting a punitive damage award. This was the first time the court had addressed this common but controversial practice directly in a majority opinion. The court also characterized the ratio of the compensatory damages to the punitive damages as unreasonable. However, when the Utah court again reviewed the case, it lowered the punitive damage award to $9 million, an amount that still exceeds the guidelines issued by the nation?s highest court. The U.S Supreme Court declined to review its decision, letting the Utah Supreme Court ruling stand.

In State Farm v. Campbell, the high court elaborated on an earlier 1996 decision in an Alabama case, BMW of North America, Inc. v. Gore, which set out three guidelines to determine when punitive damage awards are constitutional. Justice John Paul Stevens, writing for the majority, described the three-part fairness test: the degree of reprehensibility of the defendant?s conduct; the ratio of punitive to compensatory damages or actual harm to the plaintiff; and the difference between the award and comparable penalties under the law. Applying these precepts to the BMW case, Justice Stevens said that BMW had not acted in bad faith and had caused only minor economic loss (as opposed to personal injury); that the ratio of punitive damages to actual harm was 500 to 1; and that under Alabama?s Deceptive Trade Practices Act, the defendant would have paid a $2,000 penalty, a tiny fraction of the award, and lesser amounts in some other states.

While punitive damages are awarded nationally to a small percentage of plaintiffs, about 4 percent according to a 2002 study by Cornell University professors, in some jurisdictions the percentage of punitive damage awards can be exceedingly high. A 1997 study conducted by Cornell University and the National Center for State Courts found that in one Georgia court punitive damages were awarded in 25.8 percent of cases in which plaintiffs prevailed. Because without clear limits there can be dramatic exceptions to the norm, fear of an irrational punitive damages award still influences settlements, tort reform advocates note.

Scientific Evidence: The U.S. Supreme Court ruled in 1993 on the admissibility of scientific theories as evidence in federal courts. The decision in the case, Daubert v. Merrell Dow Pharmaceuticals Inc., focused on the use of "junk science" in personal injury trials. A federal district court upheld a ruling that the evidence the plaintiffs used was "sub-standard"?it had never been published, nor had it gone through a "normal peer-review process." The federal court ruled that such a process was necessary to prove the general acceptance rule of evidence.

In the past, federal courts had relied on two measures of acceptancy for scientific evidence. The first, used in this case, is known as the Frye rule, after a 1923 case in which the judge refused to allow the results of an early lie detector on the grounds that the results of lie detector tests were not generally accepted by scientists and others in the field as reliable. A less stringent rule was adopted in 1975 by Congress as one of the Federal Rules of Evidence. That rule (702) says that experts who are qualified in their field may present their ideas as evidence to a jury, even if their ideas do not represent a consensus of their colleagues, as long as the evidence is relevant to the case and may help a jury to reach a verdict.

In a unanimous decision, the Supreme Court said that the newer rule should be used to determine the admissibility of evidence. In addition, the high court said that federal judges must act as gatekeepers, excluding testimony that is not relevant or reliable. Writing for the majority, Justice Harry A. Blackmun said that federal judges possess the capacity to determine whether the reasoning or methodology underlying the testimony is scientifically valid and to decide what evidence the jury should hear.

In December 1997, further defining its 1993 decision in Daubert vs. Dow, the U.S. Supreme Court

ruled that trial judges may not only act as gatekeepers to ensure scientific testimony is relevant and reliable, but also that their decisions should be upheld unless found to be manifestly erroneous. Then, in March 1999, broadening the scope of the 1993 ruling, the high court said in the case of Kumho Tire Co. v. Carmichael that a judge?s gate keeping powers were not limited to scientific matters. The Kumho case, which involved the failure of a minivan tire on a cross country trip, centered on the testimony of a mechanical engineer who had worked in the field of tire design for 10 years.

Gun liability: The shootings at the Sandy Hook primary school in Newtown, Connecticut, in 2012 raised the level of debate about gun control and how to reduce the number of gun-related deaths. A number of states considered mandatory liability insurance for gun owners following the shootings, but currently no primary insurance company offers gun liability insurance. Excess personal liability coverage for gun owners is available through some firearms associations.

Advocates of mandatory liability insurance believe that requiring the coverage would create an incentive for gun owners to consider safety measures such as safety locks or to purchase less powerful weapons. But accidental deaths represent just a small fraction of gun-related fatalities. Insurance generally covers accidents and unintentional harm. No insurer offers coverage for illegal acts, which make up the bulk of the recent incidents that are spurring gun control debates.

Growth in Delays: Compounding the problem of growth in the volume of lawsuits is growth in the time it takes to move a case through the trial process, resulting in backlog and delay. One avenue being explored to lessen delay is known as alternative dispute resolution (ADR), which includes arbitration, where disputants agree to be bound by the decision of an independent third party, and mediation, where a third party is used to try to arrange a settlement between the contending parties. ADR is being used successfully by many insurance companies to resolve disagreements among parties to auto accidents and by many businesses although it has yet to gain universal acceptance. Property insurers may also use ADR to resolve disagreements between claimants and their insurers about catastrophe damage claims. Meanwhile, both lawyers and organizations that use ADR are investigating ways of qualifying mediators and setting other guidelines to govern the legal process, including class action suits.

In 2013 the nation?s largest arbitration provider, the nonprofit Arbitration Forums, resolved more than 533,000 inter-insurance disputes, valued at $2.4 billion. The organization?s arbitration services save about $700 million annually in litigation costs. Disputes leading to arbitration typically arise when insurance or self-insured companies believe their policyholders or employees are not at fault or due to disagreement over the percentage of liability or the amount of damages. More than 85 percent of these disputes involve auto collisions.

State Reform Measures: The large number and size of awards, the belief that the pendulum has swung too far in favor of plaintiffs and the realization that the costs of the civil justice system are borne by individuals in the form of higher insurance premiums, directly or indirectly, has led to a groundswell of support for civil justice reforms. Tort reform advocates believe changes are necessary in four key areas to help restore fairness to the civil justice system: modification of the joint and several liability rule, revision of the collateral source rule, a cap on noneconomic damages, restrictions on punitive damage awards and reinstatement of the state-of-the-art defense. Since the tort reform effort began in earnest in the mid-1980s, hundreds of reform measures have been passed, although some have been challenged and some overturned. Reform measures may completely abolish a rule or modify it by limiting its application.

The collateral source rule refers to a rule of evidence that bars the introduction of any information indicating a person has been compensated or reimbursed by any source other than the defendant. Approaches taken by modifying legislation include permitting consideration of compensation or payments received from some or all collateral sources and requiring that any award be offset by the

amount of collateral source payments.

The concept of capping noneconomic damages has been endorsed by many states. In some states, laws now limit the liability of defendants in liability suits in one of several ways: by limiting recovery of a particular type of damages (usually noneconomic damages, such as pain and suffering); by limiting the total amount of damages recoverable; or by placing an absolute cap on liability, as in wrongful death cases. Reform measures may apply to all tort suits or only to specific types, such as medical malpractice.

Originally designed to punish defendants who showed a wanton disregard for safety, punitive damage awards no longer are limited to such cases and may substantially exceed the amount of compensatory damages awarded. More than half the states have passed laws that limit the imposition of such damages. Reform measures may require punitive damage awards to be paid to the state; set limits on the amount that may be awarded in total or relative to compensatory damages; limit the type of case in which they may be awarded; or require hearings to establish a case for punitive damages before they may be sought in court. Some states have never had provisions for punitive damages.

Bad Faith: Over the past few years there has been an increase in so-called ?bad faith? legislation introduced states legislatures. Bad faith is a legal term used to denote the kind of complaint that may be filed against an insurance company for alleged unfair claim settling practices.

All states have laws that give the insurance commissioner power to regulate unfair claims settlement practices, such unreasonable denials or delays in settling claims. Regulations are based on the Unfair Claims Settlement Practices Model Act created by the National Association of Insurance Commissioners in the 1990s. Insurers that violate state laws based on the act can be fined or have their licenses revoked. In cases of egregious bad faith, punitive damages may be awarded against the insurer, enabling the plaintiff to recover an amount larger than the face value of the insurance policy.

There are no provisions in the act for a tort lawsuit to be filed directly against an insurance company either by a first-party (a policyholder who has a property insurance claim) or by a third-party claimant (an individual who is filing a liability claim against the policyholder). However, over time, some states have modified their versions of the Model Act to allow first-party lawsuits and expanded the act?s provisions in other ways. The bad faith legislation introduced in various states would expand existing law. Depending on the state, such legislation would to allow third-party claimants to file lawsuits against an insurer, extend definitions of unreasonable settlement practices to very specific and narrow situations or enable lawsuits to be filed for a single infraction, rather than for a pattern of questionable business practices. Insurers support consumer protections but fear that the expansion of existing regulations being sought in some states will lead to higher insurance premiums. Companies may be pushed into settling claims, even those that may be frivolous or fraudulent, under the threat of lawsuits for failure to deal with claimants in good faith.

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