Insurance Law: End of the Line for 'Procedural Bad Faith' in Connecticut

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The Connecticut Supreme Court has finally shed the illuminating radiance of reason and respect for traditional rules of contract to dispose of the shadowy notion that insurance companies that have fully complied with their policies can still be sued for how they acted toward a policyholder seeking money for an uncovered claim.

As a practical matter, the issuance of controlling law on the issue from the Connecticut Supreme Court should simplify insurance coverage cases in the U.S. District Court where dicta from a respected judge was frequently cited to keep alive a companion cause of action that raised issues such a motive that are difficult to resolve short of trial.

The Connecticut Supreme Court's decision earlier this year ended years of speculation among practitioners, legal writers, and federal judges in Connecticut, who have all tried to read the tea leaves and predict whether Connecticut would join the very small number of states to adopt this relatively new theory of recovery. Many in the insurance industry were concerned over decisions from the federal bench here predicting that Connecticut would align itself with those states that have recognized "procedural bad faith," subjecting claims professionals to seemingly boundless discovery obligations and leaving all of their actions open to second-guessing even where there was no real dispute that coverage for a matter was properly denied. With the high court's decision this year, those doubts have been laid to rest.

To understand the import of this decision, it helps to know what procedural bad faith is, and what it is not. Procedural bad faith, in brief, is a cause of action for improper processing or handling of an insurance claim that is independent of whether the insurance company owed any policy benefits to the policyholder.

This is not to be confused with an ordinary claim for insurance bad faith. In the traditional insurance bad faith claim, the policyholder claims that the insurance company breached some express duty under its contract, and did so under circumstances suggesting a dishonest purpose or sinister motive (not just a mistake).

In a procedural bad faith claim, the "breach of an express duty" requirement is removed. In other words, in states that recognize the cause of action, a court can find that the insurance company did not owe the policyholder a duty to defend it from a lawsuit, a duty to pay any insurance proceeds, or any other duty under the insurance policy; but the policyholder may still recover if the court finds the

insurance claim was not handled properly. States that recognize procedural bad faith (most notably Washington) have based it on the premise that the purchase of insurance coverage brings the policyholder peace of mind in knowing an insurance claim will be dealt with properly, and that improper handling, even in the absence of a breach of contract, can disturb that peace of mind and erode the policyholder's sense of security.

The decision that foreclosed procedural bad faith in Connecticut, Capstone Building Corp. v. American Motorists Insurance Co., may well have been the pinnacle of a very productive year for insurance law in Connecticut. Indeed, 2013 has been witness to several insurance-related decisions issuing from Connecticut's high court that have been significant enough to merit examination and top-story coverage from insurance law publications. The Capstone decision alone offered new guidance on three separate questions of insurance law, including procedural bad faith.

The case stemmed from claims of defective construction concerning a new student housing complex at the University of Connecticut. UConn notified the project's general contractor of the alleged defects. The contractor, in turn, put its liability insurance carrier on notice, and the insurance carrier denied coverage without conducting an investigation. After UConn and the contractor settled their claims in mediation, the contractor sued its insurance carrier. Among other claims, the contractor claimed that the insurance carrier's decision not to conduct an investigation was taken in bad faith.

What takes this claim out of the realm of traditional insurance bad faith, and into that of procedural bad faith, is that an investigation was optional under the insurance policy. In other words, the insurance carrier had no contractual duty to conduct the investigation. In such a circumstance, could the decision not to conduct an investigation be actionable "bad faith"? Did the decision allowed by the insurance contract nonetheless violate a right to "peace of mind" not spelled out in the words of the contract of insurance?

The Connecticut Supreme Court's answer was a firm "no." In its discussion of the question, the court made it clear that the only type of bad faith that would be recognized under Connecticut law, in insurance cases or otherwise, was the traditional kind. In other words, a claim for bad faith has to be based on the denial of the receipt of an express benefit under the insurance policy. Because the option to investigate was discretionary, it could not form the basis for a bad faith claim. As for procedural bad faith, the high court extinguished it in a footnote, declaring bluntly, "we decline to adopt this theory of bad faith."

The decision signals an end to years of uncertainty about the viability of the claim under Connecticut law. In 2000, Judge Christopher F. Droney, apparently reacting to adoption of this novel theory in a few Western states, predicted that Connecticut's high court would not limit bad faith to situations where the insurer breached an express duty under an insurance policy and denied an insurance company's summary judgment motion on that basis. That decision had a ripple effect on insurance practice in Connecticut, as additional federal decisions relied on

the earlier decision in keeping such claims alive (the state courts were largely silent), and the threat of a procedural bad faith claim could significantly impact a defendant insurance company's strategy, even where the absence of a duty under the insurance policy was clear.

To be sure, a litigious policyholder still has plenty of options to choose from in the toolbox of claims, including traditional insurance bad faith and various statutory causes of action. After all, the policy of insurance, and the contractual relationship it creates, is regarded by the law as being unlike other contracts, and a unique body of law has grown around this relationship with its own rules that often favor the policyholder.

For example, unclear terms in insurance policies are always interpreted in favor of granting insurance coverage. This is so not only where the policyholder is an individual with a homeowner's or auto policy, but where the policyholder is a large corporation with attorneys and bargaining power that are equal to, or even greater than, those marshaled by the insurance carrier. (In light of the regard the law sometimes shows toward policyholders, and its occasional skepticism toward the policy arguments of insurance carriers, Connecticut practitioners who represent policyholders have been known to refer to themselves, tongue-in-cheek, as the "white hats" – i.e., the good guys in old Western film parlance, recognized by their headwear.)

But even in the context of a body of law that has special regard for the concerns of policyholders, the notion of making an insurance carrier liable for claims processing "duties" not appearing in the contract were a bridge too far, at least in Connecticut. As the Connecticut Supreme Court, quoting a decision from Wisconsin, put it, "permitting a party to succeed on a bad faith claim completely uncoupled from a prerequisite breach of contract would invite the filing of unmeritorious claims, focused on the insurer's alleged misconduct." As of 2013, Connecticut has finally closed the door on
such unmeritorious claims and the complications they have brought to litigation of the rights created by an insurance policy.

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