



**PCI ANALYSIS:
THE IMPACT OF ENACTING “BAD FAITH” LEGISLATION
ON MICHIGAN’S INSURED CONSUMERS**

A group of bills under consideration in Michigan could result in legal changes that would permit or expand the rights to file bad faith claims against insurers for alleged unfair claim practices. This document describes the cost impact of bad faith legislation, as analyzed by the Property Casualty Insurers Association of America.

If bad faith legislation were adopted in Michigan, it could result in an increase in the amount of litigation as well as higher costs. Specifically, an estimated \$554.2 million more in premiums could be passed on to the state’s insured drivers and homeowners. In addition, bad faith legislation may discourage insurers from settling claims promptly and fairly, along with protecting their policyholders’ interests by investigating suspect claims and effectively fighting against fraud.

Most states including Michigan do not permit recoveries for alleged “bad faith” by first- and third-party claimants. However, because all contracts including insurance policies contain implied covenants of good faith, all states do allow policyholders to bring breach of contract claims alleging bad faith in claims handling or denial against their insurance companies. Specifically in Michigan,

- Section 500.2026 of the Insurance Code specifically declares certain conduct by insurers to constitute “unfair methods of competition and unfair or deceptive acts or practices.”
- Section 500.2006 of the Insurance Code provides for 12 percent interest commencing 60 days after receipt of satisfactory proof of loss.

As such, there is no need for bad faith laws in this state as the Michigan Office of Financial and Insurance Regulation (OFIR) closely monitors insurers’ conduct and any potential unfair claims settlement practices. If relevant statutes, case law and regulations are violated, monetary penalties are imposed. Bad faith legislation would be redundant to OFIR requirements and procedures that are working properly.

Proposals to enact bad faith laws are typically intended by plaintiffs’ lawyers as a weapon to force excessive settlements. If enacted, they would encourage claimants to file additional lawsuits that result in costly out-of-court settlements and/or an increase in the number of frivolous lawsuits. This pattern was observed in the following scenarios in two other states:

- During the 1980s, the California Supreme Court allowed second lawsuits if an inflated settlement demand was not met. According to California Judicial Council records, auto injury lawsuits filed every year almost doubled. Settlements from insurers zoomed. Since personal injury lawyers often receive 40 percent, they made millions. As a result, consumers’ insurance rates skyrocketed. Finally, the Supreme Court outlawed these second lawsuits. Since then, the

number of auto injury lawsuits is back to normal. According to the Department of Insurance, insurance rates are down over 20 percent.¹

- Washington State enacted its first-party bad faith law, effective December 6, 2007. By February 5, 2009, over 1,000 notices of intent to file lawsuits pursuant to the new law had been filed with the Washington Office of the Insurance Commissioner.² Both settlements and lawsuits are expected to result in an increase in the cost of insurance claims.

In its recent study of first-party bad faith laws, the actuarial firm of Milliman, Inc.³ determined that the average premium increase across five states which had enacted these laws ranged from about 3.5 percent to 7 percent. If bad faith laws were enacted in Michigan, similar increased costs could also be passed on to the state's insured drivers and homeowners in the form of higher premiums. Using the upper limit of a 7 percent increase as experienced in other states, the table below presents the estimated overall potential premium increases for personal auto no-fault (personal injury protection – PIP), uninsured/underinsured motorists, liability, and physical damage coverages, and the homeowners line of business if bad faith laws are enacted in Michigan.

Michigan	
Estimated Impact of Bad Faith Legislation on Insurance Premiums	
	Additional Overall Premiums
Personal Auto No-Fault (PIP)	\$155.5 million
Personal Auto UM/UIM	\$2.6 million
Personal Auto BI and PD Liab.	\$63.1 million
Personal Auto Physical Damages	\$185.2 million
Total Personal Auto	\$406.5 million
Homeowners	\$147.7 million
Grand Total	\$554.2 million
<i>PCI, based on data compiled by the National Association of Insurance Commissioners</i>	

Based on the state's 2007 premium volume of \$5.8 billion for no-fault, uninsured/underinsured motorists, liability and physical damage coverages, PCI finds that a 7 percent increase could result in an additional \$406.5 million in personal auto premium if first- and third-party bad faith laws were adopted in Michigan. Applying the same 7 percent to the state's residential property insurance premium of \$2.1 billion could yield an additional \$147.7 million to the homeowners line of business. In total, the enactment of first- and third-party bad faith laws might mean about \$554.2 million more in

¹ Source: League of Women Voters, www.smartvoter.org/2000/03/07/ca/state/prop/30/

² The number of notices was reported by the Washington Office of the Insurance Commissioner to the Insurance Research Council in response to a public records disclosure request on February 10, 2009.

³ Milliman, Inc., *The Impact of Engrossed Substitute Senate Bill 5726 on Insurance Rates*, September 20, 2007, commissioned by Consumers Against Higher Insurance Rates – Washington

premiums that could ultimately be paid by the insured private passenger drivers and residents of this state.

Moreover, a bad faith law in essence would establish a new standard for claims handling related to non-economic damages. In many cases, bad faith claims would be speculative and prone to fraud and significant attorney fees, thus adding more costs to the auto insurance system. According to the American Tort Reform Foundation, “allegations related to fraudulent (health care) screenings continue to mount, including most recently in Michigan.”⁴

In conclusion, few measures appear to be as costly to consumers or as damaging to the state’s insurance industry as bad faith legislation. The State of Michigan already provides three avenues for policyholders to bring claims against insurers:

- Filing a complaint with OFIR under the existing unfair practices law, resulting in fines and penalties;
- A breach of contract lawsuit against the insurer, allowing for money damages under the policy; and
- 12 percent interest.

The competitive nature of Michigan’s insurance industry places strong pressure on insurers to deliver good and fair customer service when a claim is settled. A bad faith law would not benefit the state’s insured drivers and homeowners; instead, it may likely harm them by raising their insurance rates. During this time of economic hardship, keeping costs down for Michigan consumers should be the most significant consideration.

*The **Property Casualty Insurers Association of America (PCI)** is a national trade association consisting of more than 1,000 insurers of all sizes and types that write 36 percent of the personal auto, homeowners, business and workers compensation insurance in the country. PCI members write 43 percent of the total personal auto market in the country and 41 percent of the total personal lines market in Michigan.*

⁴ American Tort Reform Foundation, “Judicial Hellholes, 2008/2009;” screenings pertain to those that personal injury lawyers have been using to recruit non-sick individuals as plaintiffs. While these fraudulent claims are related to asbestos and silica, they can just as easily relate to the personal auto and/or homeowners line.