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March 16, 2014

Oregon State Legislature
Oregon State Capitol
Senate Committee on Judiciary
900 Court Street NE
Salem, OR 97301

Re: Senate Committee on Judiciary, March 16, 2015 Hearing on SB 313 and SB 314
State Farm Insurance Companies' Written Testimony in Opposition

Senator Prozanski, Chair, Senator Kruse, Vice Chair, and Members of the Committee:

Thank you for considering this written testimony by State Farm Insurance Companies in opposition to SB 313 and SB 314.

This session five bills have been filed,[1] all having one purpose: to create in Oregon a third-party right to a "second lawsuit" similar to what the California Supreme Court created in its 1979 *Royal Globe v. Superior Court*[2] decision, and then repudiated in *Moradi-Shalal v. Fireman's Fund Ins. Companies*[3] in 1988. In California, the result was increased lawsuits that overwhelmed the courts, a rise in fraud-related insurance claims, and higher rates for insurance consumers: in short, a decade of dysfunction. Oregon consumers don't need or want that.

I. Insurance: a Highly Regulated Industry

Why shouldn't insurance be included in the UTPA like other businesses? The answer is simple: insurance has its own regulator and is already subject to a robust regulatory regime. The Oregon Insurance Code (ORS Title 52) has fourteen chapters regulating every aspect of the insurance industry; OAR Chapter 836 has 37 divisions of regulations that further define the duties and obligations of insurance companies from policy forms to rates to sales practices to claims handling.

Before an insurance policy form can be sold to the public, it must first be submitted to the Insurance Division and approved.[4] Before an insurer can sell the policy, it must file the rates with the Director of the Department of Consumer and Business Services (DCBS)[5], and the rates

[1] These bills are SB 314 and HB 2248, SB 510 and HB 2248, and SB 313. SB 314/HB 2248 would do this by creating a new right of action under the Unfair Trade Practices Act (UTPA) (ORS 646.605, *et seq.*); SB 510/HB 2248 would establish a direct suit by a third party claimant against an insurer for alleged violations of the Unfair Claims Settlement Practices Act (ORS746.230); SB 313 creates a hybrid by both invoking the UTPA and creating a new right of action for any violation of ORS Chapter 746 (Insurance Trade Practices).
[2] 23 Cal.3d 880, 153 Cal.Rptr. 842, 592 P.2d 329 (1979).
[3] 46 Cal.3d 287, 250 Cal.Rptr. 1167, 58 P.2d 58 (1988).
[4] ORS 742.003.
[5] ORS 737.205.

cannot be "be excessive, inadequate or unfairly discriminatory."[6] Agents that sell the policies must apply for the license and meet certain criteria,[7] pass an examination,[8] and then obtain and maintain the license.[9]

The claims process is highly regulated by both the Insurance Code and Administrative Rules,[10] and the DCBS Director has broad authority to enforce the provisions of Title 56, in general, and ORS 746.230 in particular. During the 2013 Legislative Session, the Director was granted additional powers to seek restitution on behalf of consumers.[11]

The Director can conduct examinations of insurers and their practices at any time,[12] and may institute enforcement proceedings on their own[13] or request the Attorney General to do so on their behalf.[14] Even though the professionals, including potentially, appraisers, independent actuaries, independent certified public accountants or other specialists, are retained by the Director, the cost of their services and other expenses must be borne by the insurer being examined.[15]

II. What These Bills Do

Insurance Practices. SB 313 permits a private individual that claims to have suffered an "ascertainable" loss of money or property to bring an action against an insurer or other person that is alleged to have committed any unlawful insurance practice. It allows for the awarding of actual damages or statutory damages of $200, whichever are greater, punitive damages, equitable relief, and directs the court to award attorneys' fees. It allows class actions, and permits the attorney general to "punish" an unlawful insurance practice under Unlawful Trade Practices Act (UTPA).

UTPA. SB 314 adds insurance unfair claims settlement practices to the definition of real estate, goods and services that are subject to penalties under the UTPA, and will allow any person claiming an "ascertainable loss", based upon existing prohibited practices set forth in the UTPA, or a claimed violation of an Unfair Claims Settlement Practices (UCSP) standard set forth in the Insurance Code (ORS 746.230), to sue an insurer, a claim representative, or an insurance agent. It permits an individual to recover actual damages or statutory damages of $200, whichever is greater, punitive damages, and to obtain appropriate equitable relief. Attorneys' fees are recoverable. Same as HB 2248.

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[6] ORS 737.310.
[7] ORS 744.059.
[8] ORS 744.058.
[9] ORS 744.053.
[10] ORS 746.230; OAR, Ch. 836, Div. 80. In particular, OAR 836-080-0235 and 836-080-0240 outline strict requirements for claims processing and handling.
[11] ORS 731.256.
[12] ORS 731.236; 731.300.
[13] ORS 731.256.
[14] ORS 731.258.
[15] ORS 731.302.

Under both of these bills, the newly authorized lawsuits will not be for claimed damages or benefits at issue in an underlying insurance dispute. They will instead be "extra-contractual" causes of action, that can be brought by first or third parties claiming additional consequential damages, punitive damages, attorneys' fees, and "appropriate equitable relief."

As this Committee contemplates the changes to Oregon Law that will occur if either SB 313 or SB 314 becomes law, it should carefully consider each bill's anticipated effect on the Oregon insurance marketplace. There is an irrefutable relationship between insurers' exposure to extra-contractual lawsuits (premised upon allegations of unfair claims handling), and higher insurance costs paid by consumers in those states that allow them.[16] State Farm respectfully asks legislators to step-back and consider whether there is a "problem" that needs to be fixed. Oregon's laws and judicial system already provide consumers with rights to ensure fair recovery of benefits and damages.

III. The California *Royal Globe* Experience

What happened in California during the decade following *Royal Globe*? This is best summed up by the California Supreme Court in *Moradi-Shalal*:

> Confirming Justice Richardson's prediction in his *Royal Globe* dissent, several commentators have observed that the rule in that case promotes multiple litigation, because its holding contemplates, indeed encourages, two lawsuits by the injured claimant: an initial suit against the insured, followed by a second suit against the insurer for bad faith refusal to settle. (Comment, supra, 12 Sw.U.L.Rev. at p. 125; Price, supra, 31 Hastings L.J. at pp. 1186.) As a corollary, *Royal Globe* may tend to encourage unwarranted settlement demands by claimants, and to coerce inflated settlements by insurers seeking to avoid the cost of a second lawsuit and exposure to a bad faith action. (Price, supra, 31 Hastings L.J. at pp. 1186–1187; Note, supra, 7 Pepperdine L.Rev. at pp. 790–791; Allen, supra, 13 Pacific L.J. at p. 851.)
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> Thus, one author observed, "One result of this decision is that every time a demand is now made to settle a lawsuit, an additional demand is likely to be forthcoming to coerce higher settlements. The demand now carries the threat that, unless settlement is immediate, a separate suit will be filed for violation of the Unfair Practices Act. The public ultimately will be affected by the additional

[16] See, *e.g.*, William G. Hamm, Jeannie Kim. Rebbecca Reed-Arthurs, *The Impact of Bad Faith Lawsuits on Consumers In Florida and Nationwide*, U.S. Chamber of Commerce's Institute for Legal Reform, (September 15, 2010), Berkeley Research Group, available on line at http://www.bizjournals.com/tampabay/pdf/william_hamm_study_-_the_impact_of_bad_faith_lawsuits_on_consumers_in_florida%5B1%5D.pdf; *Third Party Causes of Action: Effects on West Virginia Insurance Markets*, Office of the Insurance Commissioner, February 2005, available on line at http://www.wvinsurance.gov/Portals/0/pdf/reports/third_party_causes_action_effects.pdf; Angela Hawken, Stephen Carroll, and Allan Abrahamse, *The Effects of Third-Party, Bad Faith Doctrine on Automobile Insurance Costs and Compensation* (Rand Institute for Civil Justice, 2003), available on line at http://www.rand.org/pubs/monograph_reports/MR1199.html.

> drain on judicial resources. Moreover, the public will indeed suffer from escalating costs of insurance coverage, a certain result of inflated settlements and costly litigation." (Price, supra, 31 Hastings L.J. at p. 1186.)
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> Other commentators agree that *Royal Globe*, and its allowance of a direct action against the insurer, may result in escalating insurance costs to the general public resulting from insurers' increased expenditures to fund coerced settlements, excessive jury awards and increased attorney fees. (Allen, supra, 13 Pacific L.J. at p. 851; Note, supra, 7 Pepperdine L.Rev. at pp. 792–793; Note, supra, 15 Sw.U.L.Rev. at p. 393.) As stated by one writer, "The increased settlement costs required to settle the actual lawsuit and the potential one that hovers over most litigation involving an insured defendant will obviously result in higher premiums. In addition, those insurers that have the courage to refuse settlement where they do not feel it is warranted will necessarily be the subject of additional litigation because they will not in all instances have guessed correctly regarding the value of the case. When they have guessed incorrectly, *Royal Globe* encourages lawsuits against them." (Allen, supra, 13 Pacific L.J. at p. 851.)
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> Most authors have noted another unfortunate consequence of our holding in *Royal Globe* that insurers owe a direct duty to third party claimants: It tends to create a serious conflict of interest for the insurer, who must not only protect the interests of its insured, but also must safeguard its own interests from the adverse claims of the third party claimant. This conflict disrupts the settlement process and may disadvantage the insured. (Allen, supra, 13 Pacific L.J. at p. 851; Price, supra, 31 Hastings L.J. at pp. 1183–1184; Note, supra, 7 Pepperdine L.Rev. at pp. 791–792; Note, supra, 15 Sw.U.L.Rev. at p. 393.)[17]

During the decade following *Royal Globe*, the concerns noted by Justice Richardson indeed came to pass. Nearly every claim settlement demand included the standard *Royal Globe* letter reminding the insurer of its obligations under the ruling of that case and threatening a subsequent law suit if the demands were not met. The impact on insurance consumers was predictable and real.

A. Impact on the Court System

Because of *Royal Globe*, the settlement value of minimal claims increased significantly, making even minor injury claims more likely to be litigated. Indeed, automobile personal injury suits nearly doubled between 1982 and 1987, "reaching as many as 91,450 cases, and then tumbled between FY89 and FY98, resulting in a loss of 33,100 cases."[18]

[17] *Moradi-Shalal*, pp. 301-302. Emphasis added.
[18] Report from the Center for Court Research, Innovation, and Planning, California Administrative Office of the Courts, 2003, *Exploring the Work of the California Trial Courts: a 20-Year Retrospective*, p. 43; available on line at http://www.courts.ca.gov/7808.htm.

> In 1979, *Royal Globe Ins. Co. v. Superior Court* gave third parties injured by a policyholder a claim against the insurance company on the basis of "bad faith." The number of bad-faith claims filed jumped immediately after *Royal Globe*, as did the amounts paid by insurance companies to settle the underlying claims. The greater payouts made smaller claims more economical for attorneys to handle. This fact may account for some of the increase in the 1980s.
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> In 1988, *Royal Globe* was reversed in *Moradi-Shalal v. Fireman's Fund Ins. Cos*., and the economics of tort litigation again changed. By 1992, payments by insurance companies to claimants were 29% lower than might have been expected based on the payouts in the *Royal Globe* era. By 1997, payouts were 35% lower. This change likely resulted in a decline in representation for people with smaller claims and, possibly, a decline in filings.[19]

These increased filings impacted the availability of the courts, creating a backlog, particularly in Los Angeles, where it was very difficult to get to get to trial in less than five years.

B. Increased Fraud

Following the decision in *Royal Globe*, claims behavior changed significantly. Some involved outright fraudulent claims where even very minor accidents with little or no damage resulted in bodily injury (BI) claims. In the year prior to *Royal* Globe, the ratio of BI to property damage (PD) claims was about 43% higher in California than in other states—in California, 30 % of PD claims included BI; in other states, 21%. In the decade following *Royal* Globe, the ratio in California climbed to 46%, while in other states it rose to only 27%, a difference of 70%.[20] For some reason, drivers in California were more "fragile" than those in other states during the *Royal* Globe era.

The threat of a subsequent *Royal Globe* action also resulted in inflated claims and changed claims handling behavior. In the years prior to *Royal Globe*, the trend in average BI compensation was generally the same as in other tort states, and to the extent there was a difference, average BI compensation was falling compared to other states. *Royal Globe* reversed this, causing significant increases in BI claims payments. But, with the *Moradi-Shalal* decision, California experienced significant decreases in BI compensation compared to most other tort states.[21]

The types of claims brought under *Royal Globe* that would not have been brought otherwise were most likely those of lesser or doubtful value, typically low-speed rear-enders with little or no property damage. Significantly, even though BI total payments increased, because the frequency of BI claims also increased and many of these were doubtful or of limited value, the

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[19] *Ibid.*, p. vii.
[20] Angela Hawken, Stephen Carroll, and Allan Abrahamse, *The Effects of Third-Party, Bad Faith Doctrine on Automobile Insurance Costs and Compensation* (Rand Institute for Civil Justice, 2003), p. 26; available on line at http://www.rand.org/pubs/monograph_reports/MR1199.html.
[21] *Ibid.*, pp. 18, 27.

average per claim BI payment decreased.[22] Notwithstanding, handling and litigating more BI claims increased costs, resulting in higher insurance premiums. With the overturning of *Royal Globe*, this aberrant claiming (and claims handling) behavior returned to normalcy, causing the gap between California and other tort states to essentially disappear.[23]

C. Higher Insurance Rates

It is really a matter of simple math, increased suits and commensurate litigation costs, plus more claims with higher severity, must result in higher insurance premiums, and in California they did: *Royal Globe* increased BI liability premiums from 32% to 53%.[24] It is likely that a legislatively imposed system in Oregon as mandated by SB 313 or SB 314 would have a similar result.

Oregonians don't need these bills, and they do not want the increased insurance costs that would accompany them. In a 2015 polling study by DHM Research, 69% of voters said they believe they are adequately protected against unfairly denied claims by the existing regulatory system. Indeed, 91% of voters that filed insurance claims within the last five years believed their insurance company handled the claim fairly. Finally, 75% of the voters polled do not want to pay higher insurance premiums for an additional recourse against their insurance company.

IV. Conclusion

On July 30, 2014, the Oregon Insurance Division (OID) published its report for Oregon Insurance Complaints for Calendar Year 2013.[25] Keeping in mind that insurers handle close to a million claims annually in Oregon in just the auto and homeowners' lines, below is a chart summarizing the complaints in three main lines affecting consumers:

Line of Insurance	Total Complaints	Confirmed Complaints
Auto	1,392	376
Homeowners	312	69
Health	1,144	382
Total	**2,848**	**827**

The total for auto and homeowners' is 1,704. Assuming one million claims in just those two lines, there are about 1.7 complaints for every 1,000 claims, and only 445, or one in four, are confirmed. Finally, it must be remembered that these are complaints for *any reason*, even those that do not involve claims. Those related to claims only would be less.

[22] *Ibid.*, p. 27.
[23] *Ibid.*, p. 38.
[24] *Ibid.*, p. 52.
[25] *Oregon Insurance Complaints – All, From Calendar Year 2013*, Oregon Department of Consumer & Business Services, available on line at http://www.oregon.gov/DCBS/insurance/gethelp/Documents/complaint-stats_2013.pdf.

What all of this signifies is that the existing regulatory system is working pretty well, and that these bills represent a solution in search of a problem. There is simply no evidence that there is a need for them, and, as the California experience showed, any potential benefits are likely to be far out-weighed by the negative impact on consumers because of decreased access to the courts, increased fraud, and resulting higher insurance premiums.

Thank you for considering this written testimony. Please feel free to contact me at (916) 321-6915 or robert.r.nash.gted@statefarm.com if you have any questions concerning this testimony.

Respectfully submitted,

Robert R. Nash, Counsel