CHIP SHIELDS
STATE SENATOR
DISTRICT 22
N/NE PORTLAND
OREGON STATE LEGISLATURE

SB 1590: To Protect Small Business

Chair Beyer, members of the committee:

My name is Chip Shields and I represent North and Northeast Portland in the Oregon State Senate.

Insurance is the only line of business that is exempt from Oregon's anti-fraud statute. Banking used to be exempt, but the legislature removed the exemption in the 2010 special session.

We've tried in the past to bring insurance under the state's Unlawful Trade Practices Act. That bill passed the house in 2013, but died in the senate.

In the process of that discussion, it became clear to me that Oregon is an outlier in the West in that it has virtually no mechanisms to incent good faith and fair dealing by insurance companies when it comes to two issues:

1. Fulfilling the insurers' <u>duty to defend</u> the policyholder when the policyholder is being sued. The duty to defend is a very important benefit in insurance policies.

2. Timely investigation and payment of meritorious claims.

As former Stoel Rives attorney Scott Kaplan wrote in the attached memo, "You have asked why policyholders in Washington are much more likely to have their claims paid, paid in full (or closer to it), and paid more quickly with less need to resort to coverage litigation than policyholders in Oregon…The answer, in brief, is that Washington's statutory and regulatory scheme provides real incentives for insurance companies to pay meritorious claims, and pay them promptly, while Oregon law provides no such incentives. In Oregon, the incentive is for insurance companies to deny claims because even if the claim is wrongfully denied, the policyholder's only remedy is expensive breach of contract litigation to make the insurance company pay what it should have paid to begin with."

Additionally, the legislature in 2013 all-but-unanimously gave a private right of action and other tort-like remedies for mostly larger businesses in environmental insurance policies. That law, SB 814, amended the Oregon Environmental Cleanup Assistance Act (OECAA). It set forth treble damages for breaching the duty to defend; for failure to make timely investigation; for delay in timely participation in mediation; and breach of payment of meritorious claims. In other words it incentivizes good faith and discourages bad faith, but only for big businesses.

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As business attorney Kevin Mapes of Ball Janik has written, "The statutory good-faith settlement process put in place by the OECAA amendments is now being put into practice, allowing settlements to go forward...The system, in other words, is working, at least in the context of environmental claims... (but) from a public policy perspective, it seems odd at best to treat policyholders and insurers differently depending on the nature of the underlying litigation. The Oregon legislature should at least consider encouraging settlements and the efficient resolution of insurance disputes by extending OECAA's good-faith settlement presumptions and procedures to all types of coverage litigation."

Keeping in mind that small business should benefit from the same kind of policies we passed in 2013 for big business, I asked a group of bipartisan senators to come together over the last year in a workgroup to see if we could find common ground on the most pressing insurance concerns, focusing on small business. We heard from attorneys representing small business. We heard from the Washington Insurance Commissioner policy staff. We heard from an insurance broker. We heard from a small business construction company owner and we heard from Oregon Insurance Commissioner Laura Cali. The Insurance Division has reviewed the bill, and provided feedback and suggested language. They are neutral on the bill.

We looked at 17 ideas and eventually winnowed them down to 5. Those ideas are encompassed in SB 1590.

The heart of the bill, and the portion that will most help small businesses who are sued, relates to encouraging insurance companies to fulfill their duty to defend. That idea is encompassed in Section 2, subsections 2-4.

We heard testimony from those who defend businesses that insurers will frequently breach their duty to defend the policyholder when the business is being sued by a plaintiff. This is because there is no real incentive to defend. If you lose, all that happens is you have to defend the business you should have defended in the first place. Additionally in Oregon there is significant downside to becoming the first performing insurer to defend when there is more than one policy and/or insurer that could cover a claim.

We looked at tort-like remedies like treble damages, but decided on a more measured approach that kept the remedy within the confines of the policy limits. We went with codifying that if you breach your duty to defend, you forfeit your coverage defenses. In other words, if the court finds you breached your duty to defend, the consequence is that you have to pay the claim. That way the small business defendant doesn't have to. This is also known as coverage by estoppel.

This language is based on model language from the American Law Institute.

The bill also addresses other smaller issues that delay settlements.

- Transparency in insurance division complaint process: Oregon Insurance Division shall provide previous complaint information to requestors, redacted of personal information of claimant
- Regulatory estoppel: require Oregon Insurance Division to retain and enforce policy form language
- Independent counsel provision: copy Oregon Environmental Cleanup Assistance Act to ensure the court can ensure that policyholder's counsel is truly independent of the insurance company
- Farm equipment fix: tractors covered under auto or farm policy, closing a gap in coverage.

There are some amendments drafted and in LC which I would like to briefly discuss.

The -1 is language we received from the insurance division to improve the transparency piece.

There is another amendment being drafted by LC now that will clarify that the bill does not apply to workers compensation policies.

Now Mr. Chair, there are some people and groups who oppose this bill because it doesn't go far enough, and there are some people and groups who oppose this bill because it goes too far. That says to me that we struck a pretty good compromise.

A year's worth of work has gone into the bill. I hope the committee will adopt the -1 and the forthcoming workers compensation exclusion amendment, ask the President's Office to rescind the Ways & Means referral, and send the bill to the floor with a do-pass recommendation.

Thank you Mr. Chair.

MEMORANDUM

March 20, 2013

TO: JENNIFER HUDSON

FROM: SCOTT KAPLAN

RE: Contrast Between Washington's Insurance Law and that of Oregon

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I. INTRODUCTION

You have asked why policyholders in Washington are much more likely to have their claims paid, paid in full (or closer to it), and paid more quickly with less need to resort to coverage litigation than policyholders in Oregon. This disparity exists although (a) the same standard insurance policy forms are used by the insurance companies in Oregon and Washington; (b) premiums rates in Oregon and Washington are comparable; (c) insurance company loss ratios in both states are similar. The answer, in brief, is that Washington's statutory and regulatory scheme provides real incentives for insurance companies to pay meritorious claims and pay them promptly, while Oregon law provides no such incentives. In Oregon, the incentive is for insurance companies to deny claims because even if the claim is wrongfully denied, the policyholder's only remedy is expensive breach of contract litigation to make the insurance company pay what it should have paid to begin with. The policyholder is often pressured to accept a large discount on its claim simply to pay its bills without further delay and the insurance company is able to profit from the time value of holding onto the insured's money. There are no double or treble damages in Oregon or any other private remedy to give insurance companies any economic reason to do anything other than deny claims.

To make this clear, I will contrast Washington's unfair claims settlement practice law and regulation with that of Oregon.

II. DISCUSSION

A. Washington's Unfair Claims Settlement Practices Laws and Regulations

1. Washington's Unfair Claims Settlement Practices Statutes

RCW 48.30.010 provides:

> (1) No person engaged in the business of insurance shall engage in unfair methods of competition or in unfair or deceptive acts or practices in the conduct of such business as such methods, acts, or practices are defined pursuant to subsection (2) of this section.

> (2) In addition to such unfair methods and unfair or deceptive acts or practices as are expressly defined and prohibited by this code, the commissioner may from time to time by regulation promulgated pursuant to chapter 34.05 RCW, define other methods of competition and other acts and practices in the conduct of such business reasonably found by the commissioner to be unfair or deceptive after a review of all comments received during the notice and comment rule-making period.

Under RCW 48.30.015, the Insurance Fair Conduct Act, passed by the Washington Legislature in 2007,[1] the prohibition against insurance company practices defined either in the Washington Insurance Code or by the Commissioner by regulation as unfair is enforceable by private policyholders harmed by the insurance company's conduct. Additionally, RCW 48.30.015 provides for the policyholder's recovery of treble damages if its claim is unreasonably denied. The statute states:

> **RCW 48.30.015. Unreasonable denial of a claim for coverage or payment of benefits.**
>
> (1) Any first party claimant[2] to a policy of insurance who is unreasonably denied a claim for coverage or payment of benefits by an insurer may bring an action in the superior court of this state to recover the actual damages sustained, together with the costs of the action, including reasonable attorneys' fees and litigation costs, as set forth in subsection (3) of this section.
>
> (2) The superior court may, after finding that an insurer has acted unreasonably in denying a claim for coverage or payment of benefits or has violated a rule in subsection (5) of this section, increase the total award of damages to an amount not to exceed three times the actual damages.

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[1] Prior to 2007, there was a private right of action to enforce unfair claims settlement practices under the Washington Consumer Protection Act, RCW 19.86.020, the general unfair competition statute. However, the remedy was only actual damages up to $10,000 per violation, so depending on the amount of the policyholder's money the insurance company was withholding, the insurance company in some cases was better wrongfully denying the claim even if it meant paying statutory damages.

[2] A "first party claimant" is defined by RCW 48.30.015(4) as meaning the policyholder as opposed to an injured third party. The statute is not limited to what are often thought of as "first party" claims (e.g., life, health and property claims), but applies to liability claims as well.

(3) The superior court shall, after a finding of unreasonable denial of a claim for coverage or payment of benefits, or after a finding of a violation of a rule in subsection (5) of this section, award reasonable attorneys' fees and actual and statutory litigation costs, including expert witness fees, to the first party claimant of an insurance contract who is the prevailing party in such an action.

*** (5) A violation of any of the following is a violation for the purposes of subsections (2) and (3) of this section:

(a) WAC 284-30-330, captioned "specific unfair claims settlement practices defined";

(b) WAC 284-30-350, captioned "misrepresentation of policy provisions";

(c) WAC 284-30-360, captioned "failure to acknowledge pertinent communications";

(d) WAC 284-30-370, captioned "standards for prompt investigation of claims";

(e) WAC 284-30-380, captioned "standards for prompt, fair and equitable settlements applicable to all insurers"; ****

In order to file an action for treble damages under RCW 48.30.015, the insured must give the insurance company and the office of the Insurance Commissioner notice of the cause of action 20 days prior to filing suit. RCW 48.30.015(8)(a). The statute of limitation on the claim is tolled during this 20 days grace period. RCW 48.30.015(8)(d). This delay gives the insurance company time to mitigate its violations and, in our experience, has actually led to claims being paid, in one case with interest.

2. Washington's Unfair Claims Settlement Practices Regulations

Although it seems unnecessary to list all of the unfair claims settlement practices made enforceable in a private action by RCW 48.30.015, the following are some of the most common of those insurance company practices, as defined by WAC 284-30-330.

WAC 284-30-330. Specific unfair claims settlement practices defined.

The following are hereby defined as unfair methods of competition and unfair or deceptive acts or practices of the insurer in the business of insurance, specifically applicable to the settlement of claims:

> (1) Misrepresenting pertinent facts or insurance policy provisions.
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> (2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.
>
> (3) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies.
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> (4) Refusing to pay claims without conducting a reasonable investigation.
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> (5) Failing to affirm or deny coverage of claims within a reasonable time after fully completed proof of loss documentation has been submitted.
>
> (6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear. In particular, this includes an obligation to promptly pay property damage claims to innocent third parties in clear liability situations. If two or more insurers share liability, they should arrange to make appropriate payment, leaving to themselves the burden of apportioning liability.
>
> (7) Compelling a first party claimant to initiate or submit to litigation, arbitration, or appraisal to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in such actions or proceedings. ***

Thus, RCW 48.30.015, by providing an enforcement mechanism for WAC 284-30-330, allows a policyholder to file a private action in response to dilatory insurance company claims handling and against an insurance company's wrongful refusal to pay a claims fairly and in full. Additional regulatory standards made enforceable by RCW 48.30.015 include, for example, that an insurance company's investigation of a claim generally be completed within 30 days, unless it cannot reasonably be completed during this time period. WAC 284-30-370. There are also regulatory standards made enforceable by RCW 48.30.015 for particular kinds of claims, for example auto claims (e.g., WAC 284-30-390) and environmental claims (WAC 284-30-900, et seq.)

In summary, in Washington, there is a real disincentive in the form of treble damages liability against insurance companies delaying payment and wrongfully denying or underpaying claims.

B. Oregon's Lack of An Enforceable Remedy for Unfair Claims Settlement Practices

In contrast to Washington's statutory and regulatory scheme, there is no private remedy in Oregon to enforce good faith and reasonable insurance company claims handling practices. Oregon actually has on the books a statute analogous to WAC 284-30-330, defining actions such as not responding promptly to claims and wrongfully denying claims as unfair claim settlement practices, ORS 746.230. However, the statute does not provide a private right of action to enforce these standards and, in the absence of an express statutory mandate, the Oregon Supreme Court has held that there is no private right of action. *Farris v. U.S. Fid. and Guar. Co.*, 284 Or 453, 587 P2d 1015 (1978); *accord Employers' Fire Ins. Co. v. Love It Ice Cream*, 64 Or App 784, 670 P2d 160 (1983); *Pearson v. Provident Life & Accident Ins. Co.*, 834 F Supp 2d 1199 (D Or 2004).

This problem of lack of enforceable standards on insurance companies is exacerbated by the fact that when an insurance company wrongfully refuses to defend, the policyholder's only remedy is reimbursement of the defense costs the insurer should have paid to begin with. A breach of the duty to defend in Oregon does not, as in Washington, mean that the insurer must pay any judgment against the insured or reasonable settlement the insured entered into in the face of the insurance company's refusal to defend. *Compare Northwest Pump & Equip. Co. v. American States Ins. Co.*, 144 Or App 222, 925 P2d 1241 (1996)(in Oregon even if insurer breaches duty to defend, insured still must prove right to indemnity); *Overton v. Consol. Ins. Co.*, 145 Wn.2d 417, 38 P3d 322 (2002)(in Washington breach of duty to defend requires insurance company to indemnify insured for any adverse judgment or reasonable settlement.)

Thus, in Oregon an insurance company is often better off refusing to defend and taking its chances in litigation (while earning a return on the insured's money) In Washington, there is no such incentive. Rather, the Washington statutes and regulations provide a strong incentive for insurance companies to pay claims promptly and fully.