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Colorado Supreme Court sides with policyholders on statutory bad faith

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Policyholders recently received strong support from the Colorado Supreme Court with regard to policyholder disputes with insurers.

In four decisions issued in May, the court unanimously strengthened claims for statutory bad faith by rejecting a shortened limitations period; establishing that recovery for statutory bad faith under Colo. Rev. Stat. § 10-3-1116 is for "actual damages," which can be used to calculate punitive damages; and emphasizing that the statute applies to delays in payment such that an insurer does not limit its exposure by eventually paying a claim or by withholding partial payments until a full agreement may be reached.

Taken together, these decisions should fortify policyholders who have disputes with their insurers. They also raise the stakes for insurers — especially those with careless or sloppy claims-handling processes.

Paying a claim late just got a lot riskier for insurers in Colorado, because eventual payment does not reduce insurer liability. Instead, it creates liability for the delay.

In 2008, Colorado enacted Section 10-3-1116, which provides a statutory remedy for unreasonable insurer conduct. It creates a cause of action for what is commonly referred to as "statutory bad faith." It provides in pertinent part:

> A first-party claimant … whose claim for payment of benefits has been unreasonably delayed or denied may bring an action in a district court to recover reasonable attorney fees and court costs and two times the covered benefit.

In the four new decisions, Colorado's highest court rejected insurer arguments inconsistent with the terms of the statute and emphasized that "unreasonable delay" is sufficient to justify an award.

Paying a claim late just got a lot riskier for insurers in Colorado, because eventual payment does not reduce insurer liability. Instead, it creates liability for the delay. Going forward, insurers that wait to pay the undisputed portion of a claim will get stung.

COLORADO REJECTS 1-YEAR LIMITATIONS PERIOD

In an expansive ruling, the court in *Rooftop Restorations Inc. v. American Family Mutual Insurance Co.*, 418 P.3d 1173 (Colo. 2018), rejected an insurer's attempt to limit the time a policyholder has to file suit for statutory bad faith to one year.

For the last few years, several federal judges in Colorado had been ruling that a claim for statutory bad faith was "penal" in nature and therefore subject to a one-year limitations period.[1]

But in *Rooftop Restorations Inc. v. American Family Mutual Insurance Co.*, No. 15-cv-2560, 2017 WL 514060 (D. Colo. 2017), a federal judge noted the uncertainty of the law on the statute-of-limitations issue and certified the following question to the Colorado Supreme Court:

> Is a claim brought pursuant to Colorado Revised Statutes § 10-3-1116 subject to the one-year statute of limitations found in Colorado Revised Statutes § 13-80-103(d) and applicable to "all actions for any penalty of forfeiture of any penal statutes"?

On May 29, the Colorado Supreme Court unanimously and emphatically answered that question "no." Simply put, a claim under Section 10-3-1116 is not an action for a penalty.

The court held that a "defining feature of a cause of action for penalties [is] a determination of either overpayment or delinquency," neither of which are part of an action for delay or denial of benefits addressed by Section 10-3-1116.

In a footnote, the court made an important distinction: "Under this definition, penalties clearly carry a punitive element. However, we note that a cause of action is not necessarily a penalty, as that word is used by the Legislature, simply because it carries a punitive element."

With more time to file suit, a policyholder and its insurer may be able to focus on resolving a dispute without a race to the courthouse. Policyholder counsel still must be attentive to all aspects of the policyholder-insurer contracts, because a lingering question remains: namely, when does the limitations period begin to run for a claim under Section 10-3-1116?

While the date of a denial may be known,[2] the date when an insurer's actions become unreasonable is subject to proof and likely determined on a case-by-case basis.[3] While rejecting a one-year limitations period, the court did not set forth the applicable limitations period or provide any guidance as to when the statute begins to run.

It appears that the limitations period should be two years under Section 13-80-102(1)(i), which applies to "all other actions of every kind for which no other period of limitation is provided".

The two-year period — as opposed to one — holds risks for insurers because the extra time is not a reason to delay payment. The policyholder would gain a legitimate threat of a statutory bad-faith claim without having to bear the expense and delay inherent in litigation.

That said, policyholders should not use the longer two-year period to provide the insurer with any basis to claim a delay in payment was "reasonable." Prompt responses to insurer requests for information may be key.

Policyholders need to create and keep a good written record of the claims process. Policyholders and their counsel must always remember that the statute applies only to "unreasonable delay," not all delays.

AWARD FOR UNREASONABLE DELAY IS NOT REDUCED BY LATER PAYMENT

In two decisions, the court emphasized that insurers must pay what they owe when they owe it. Section 10-3-1116 provides a remedy for "unreasonable delay." It is not just a denial of coverage that exposes an insurer to liability for statutory bad faith. Dilatory payment is enough to trigger the statutory bad-faith remedies.

In *American Family Mutual Insurance Co. v. Barriga*, 418 P.3d 1181 (Colo. 2018), the court held that a policyholder's recovery under Section 10-3-1116 is not reduced by the insurer's eventual payment of the covered benefit.

In *Barriga*, American Family made various payments for repair of a fire-damaged building. The parties then disputed the cost of additional needed repairs and went to appraisal.

American Family paid the appraisal award, but a jury later determined it had unreasonably denied or delayed payments of $137,000.

The trial court doubled that amount but reduced it by the amount it determined was eventually paid by American Family after appraisal: $127,660. The Supreme Court found no basis in Section 10-3-1116 for such a reduction.

Simply, Section 10-3-1116 addresses "unreasonable" delay. If an award were reduced by the amount of delayed payments, then the statutory remedy would be for naught.

Section 10-3-1116 is "in addition to, and does not limit or affect other actions available by statute or common law, now or in the future."

Significantly, the court held that recovery for a breach of contract claim and a claim under Section 10-3-1116 does not constitute a prohibited double recovery. Thus, a policyholder may recover an amount for breach of insurance contract and two times the denied or delayed benefit, plus attorney fees.

This creates a quandary for insurers and policyholders. Once a payment is "unreasonably delayed" — such that the insurer is liable to pay twice the covered benefit — the repercussions for continuing to postpone payment may be limited to paying the additional attorney fees incurred by the policyholder.

This could be a large amount, but, depending on the size of the claim, it may provide only a limited incentive to pay a contractually owed benefit until ordered to do so by a court.

> Prompt responses to insurer requests for information may be key.

One of the lessons of *Barriga*, though, is that the "unreasonable delay" was based on American Family not making its final payment until after the appraisal process was completed. Appraisal may be a contractual right to resolve disputes, but the dispute has to be reasonable.

Using appraisal — or perhaps even arbitration for uninsured/underinsured motorist claims — to resolve unreasonable disputes may expose the insurer to liability for statutory bad faith.

The court further emphasized that disputes about one aspect of a claim do not justify delay in payment of a covered benefit. The lesson of the decision in *State Farm Mutual Automobile Insurance Co. v. Fisher*, 418 P.3d 501(Colo. 2018), is that an insurer must promptly pay any undisputed portion of a claim.

In *Fisher*, the court affirmed an award under Section 10-3-116 where the insurer delayed payment of underinsured motorist benefits that the insurer knew were owed.

State Farm conceded that over $60,000 in medical bills were reasonably necessary and related to the auto accident, and owed under the policy. But State Farm did not make the payment when it knew that money was owed, because the total value of the claim was in dispute.

It appears State Farm was treating the underinsured motorist claim as a third-party claim instead of as a first-party claim. It argued it had no duty to pay any portion of the claim until the total claim could be resolved, which is the typical process in cases involving a third-party claim.

The court dismissed that argument quickly, noting that Section 10 3-1116 refers to a "covered benefit" and not to

a "claim." Accordingly, State Farm had no basis to wait on payment of a covered benefit which was not in dispute, and Fisher was thus entitled to the remedies available under Section 10-3-1116.

While *Fisher* specifically involved an underinsured motorist claim, its holding appears far-reaching.

For example, in a property damage case, there may be agreement on several items but not all. Policyholders may now have a basis to argue that an insurer may not delay payment on any individual item as to which the parties agree that payment is due without exposing itself to liability under Section 10-3-1116.

Fisher also suggests that even where there is a dispute as to the value of an item, the insurer may not delay payment of the value determined by the insurer. The policyholder may contend that if the insurer has agreed that a covered benefit has a value of X, then the insurer cannot delay payment of X pending resolution of the entire claim.

Consider a claim for roof damage from a covered event, such as wind or hail. The policyholder contends repairs would cost $500,000. The insurer agrees repairs are needed, but asserts those repairs would cost only $300,000.

In that situation, there is agreement that the repairs will cost no less than $300,000. *Fisher* suggests the insurer must pay the policyholder the $300,000 and not wait to resolve the dispute over the remaining $200,000.

Alternatively, where the policyholder is a homeowners association and there are multiple buildings, the policyholder may contend 10 roofs need repair. The insurer may contend that only five roofs need repair. In that situation, there is agreement that five roofs need repair and the insurer should not be able to delay payment for repair of those five roofs until there is agreement about all 10 roofs.

Simply put, *Fisher* suggests an insurer must promptly pay the undisputed portion of a claim — and that the failure to do so subjects it to liability under Section 10-3-1116.

RECOVERY SURVIVES DEATH AND CAN BE ACTUAL DAMAGES

In *Guarantee Trust Life Insurance Co. v. Estate of Casper*, 418 P.3d 1163 (Colo. 2018), the court extended its ruling in *Roofing Restorations* that a claim under Section 10-3-116 is not a claim for a "penalty."

Michael D. Casper died after he obtained a jury verdict under Section 10-3-1116 against Guarantee Trust Life Insurance Co. but before judgment was entered. Under Section 13-20.101(1), actions for penalties do not survive a claimant's death. But because a claim under Section 10-3-1116 is not an action for a penalty, the estate was able to maintain and collect on Casper's claim.

The court further determined that because an award of attorney fees under Section 10-3-1116 is not a "penalty," the award constitutes "actual damages" that can be considered when calculating punitive damages.

The court did not explicitly hold that an award of two times the covered benefit would be "actual damages," but because it is not a "penalty," it can only be "actual damages."

Accordingly, the court suggested that the amount of punitive damages under Section 13-21-102 that an insurer could face is to be based on the amount to be awarded by Section 10-3-1116.

So, if the standards for punitive damages are met, then the actual damages a policyholder could receive under Section 10-3-1116 — twice the covered benefits plus attorney fees — would be doubled. This means the policyholder could recover four times the covered benefit and twice the attorney fees!

> Disputes about one aspect of a claim are not justification for delay in payment of a covered benefit.

Significantly, the court held that an action under Section 10-3-1116 "is not a 'tort action based upon personal injury.'" This suggests an action under Section 10-3-1116 is not an action personal to a party, and therefore is freely assignable.

Colorado does not allow assignments of claims for matters of personal trust or confidence, or for personal services.[4] While Colorado has permitted assignment of bad-faith claims in the context of a policyholder defendant in a liability case assigning its bad-faith claim — post-judgment — to the plaintiff in that case,[5] it has not addressed assignment of a bad-faith claim in a first-party property damage case.

CONCLUSION

Taken together, these four decisions suggest that insurers operating in Colorado should not expect favorable decisions in statutory bad-faith cases for the foreseeable future. Insurers are on notice that an "unreasonable delay" in payment of covered benefits will result in large awards.

Section 10-3-1116 is now an even more powerful tool for policyholders to wield in negotiations. If it was not clear before, insurers should now know that refusing to settle the undisputed portions of a claim will expose them to liability.

The risk to an insurer is highest with respect to first-party claims, as claims personnel may treat first-party policyholders as third-party claimants. To avoid liability, an insurer handling a first-party claim should pay what the insurer thinks it owes when that determination is made and then fight only over what is actually in dispute.

Because belated payment will not minimize or reduce liability, policyholders may bring more actions over perceived delays. As the policyholder will have received payment of its claim, asserting a claim for "unreasonable delay" under Section 10-3-1116 is a lower-risk proposition for the policyholder and the policyholder's counsel, as success under Section 10-3-1116 includes an award of attorney fees.

That said, there is some risk: The insurer could recover its attorney fees if a court determines the statutory bad-faith claim was frivolous.[6] If litigation does increase, insurers may prevail upon the Colorado Legislature to revise Section 10-3-1116.

NOTES

[1] *Hernandez v. Am. Standard Ins. Co. of Wis.*, No. 11-cv-2076, 2013 WL 6633392 (D. Colo 2013); *Phipps v. Travelers Prop. Cas. Co.*, No. 14-cv-1642, 2015 WL 5047640 (D. Colo. 2015); *Mascarenas v. Am. Family Mut. Ins. Co.*, No. 14-cv-2799, 2015 WL 8303604 (D. Colo. 2015); *Rooftop Restoration Inc. v. Ohio Sec. Ins. Co.*, No. 15-cv-620, 2015 WL 9185679 (D. Colo. 2015).

[2] *But see, e.g., Mascarenas,* 2015 WL 8303604 (question of fact as to date of denial).

[3] *See, e.g., Pinewood Townhome Ass'n Inc. v. Auto Owners Ins. Co.,* No. 15-cv-1604, 2017 WL 590294 (D. Colo. 2017).

[4] *Roberts v. Holland & Hart*, 857 P.2d 492 (Colo. Ct. App. 1993).

[5] *Bashor v. Northland Ins. Co.*, 494 P.2d 1292 (Colo. 1972).

[6] Colo. Rev. Stat. §§ 10-3-1116(5), 13-17-101.

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