Since the Michigan Supreme Court issued *Kewin v Massachusetts Mut Life Ins Co* in 1980, the judiciary has steadily narrowed the basis on which individuals and business may bring claims for bad-faith practices against insurance carriers. This article discusses those limitations and considers the remedies available to an aggrieved party.

Insurance is a tool of risk management

The law recognizes that, no matter how presented, when a claim is denied, there will be a negative reaction by the policyholder. This holds true in practice, even when the denial is correct and the policy language is clear and understandable, since disappointment is a natural response to an unexpected financial burden. Because the role of an insurance agent varies based on the expectations of the insured and other factors, each insured should choose his or her agent deliberately. The adage “jack of all trades, master of none” recognizes the importance of specialization, which applies to insurance as it does to all professions.

Theodore “Theo” Nittis and David Kramer, both former practicing attorneys, follow the specialization model at their agency, Gemini Risk Partners, LLC, which concentrates on professional liability insurance for attorneys. As Nittis explained during a recent discussion with him, there are areas of exposure that cannot be eliminated by an insurance policy: “A good insurance broker can and will help an insured client understand the high points of their coverage, but it’s impossible to escape all of the gray areas.”

Dealing with exposure to loss should be viewed through a lens of risk management. Insurance (or risk transfer) should be the primary, but not sole, approach to minimizing and eliminating risk. At Nittis’s agency, the relationship with each insured begins with risk management before binding coverage and continues through the coverage term, including claims handling.

“I counsel clients to look at the reservation of rights letter as an advanced roadmap for the insured or its coverage counsel, so that they can understand how the insurer is approaching the claim and what rules the company believes apply to the particular facts,” Nittis told me.

Unbeknown to many people, insureds are required by law to read their policies within a reasonable time of receipt and contact their agents or carriers with questions. Failure to do so could weaken a claim brought later against the agent or carrier. Of course, it would be ideal if every policyholder took the time to review his or her insurance policy and ask the carrier or agent for an explanation of convoluted provisions. Unfortunately, in many cases, an insured opens the envelope containing the policy and files it away until a claim arises.

Valid denial of coverage versus bad-faith claims practices

If a person is negatively affected by a *valid* denial, it is not unreasonable to expect greater distress if the insurance company *wrongfully* denies coverage, even if a mistake was made in good faith. Going further, if a policyholder hires an attorney...
and succeeds in a lawsuit seeking insurance coverage, he or she usually develops a reasonable expectation of recompense. But Michigan follows the American rule, which provides that attorney fees are only recoverable when expressly authorized by a statute, court rule, or a recognized exception, such as a prevailing party provision in the contract between the parties.5

Finally, there is “bad faith,” which generally means the insurance company arbitrarily, recklessly, or intentionally placed its own interest ahead of its insured at some point in the relationship, usually during adjustment of a claim.6 Even when malice is proven, punitive damages are not permitted, which is the general law in our state. However, exemplary damages are permissible as compensation for emotional pain and suffering under certain limited circumstances. “They are awardable where the defendant commits a voluntary act which inspires feelings of humiliation, outrage, and indignity. The conduct must be malicious or so willful and wanton as to demonstrate a reckless disregard of the plaintiff’s rights.”7

Experience leads to the conclusion that the American rule has a direct chilling effect on lawsuits initiated by insureds involved in coverage disputes. In particular, insureds have very few options if they can’t afford an attorney and the amount at issue is insufficient to justify a contingency fee.

Under limited circumstances, Michigan law provides for awarding attorney fees and costs to claimants who succeed in litigation; examples include the Michigan No-Fault Act and the Michigan Consumer Protection Act (MCBA). The MCBA only applies to consumer transactions and is therefore inapplicable to disputes arising from commercial insurance policies. If an insured alleges misconduct related to a consumer-based “personal lines” policy, he or she must not only prove the carrier violated the MCBA, but is also required to establish that the conduct was unlawful under Chapter 20 of the Insurance Code.13

No extra-contracualal damages for commercial contracts

The Michigan Supreme Court did away with the “adhesion contract doctrine” in 2005 and has largely limited an individual’s right to recover extra-contracualal damages for bad-faith breach of “personal” contracts, defined as related to “rights we cherish, dignities we respect, emotions recognized by all as both sacred and personal.”14

The seminal Michigan Supreme Court case on damages awarded for bad faith is *Kewin v Massachusetts Life Ins Co.* The definition of bad faith under Michigan law is “arbitrary, reckless, indifferent, or intentional actions or disregard of the interests of the person owed a duty.” The *Kewin* serves as precedent for the limits imposed on damages awarded to a plaintiff who successfully proves an insurer’s conduct meets this definition. Contrary to common belief, *Kewin* did not rule out the possibility of recovering exemplary damages in every case of breach of contract:

"We hold that, absent allegation and proof of tortious conduct existing independent of the breach, see, e.g., *Harbaugh v Citizens Telephone Co.*, 190 Mich 421; 157 NW 32 (1916), exemplary damages may not be awarded in common-law actions brought for breach of a commercial contract."

The *Kewin* Court qualified its ruling as applying to commercial contracts. It determined that a disability policy was the culmination of a financial transaction and, thus, a commercial contract, not personal, the breach of which results in no more than its monetary value. The *Kewin* opinion is commonly cited as barring recovering of exemplary damages for breach of any contract. But that skips the step of determining whether mental distress damages were within the parties’ contemplation at the time the contract was made, i.e., whether the insurance policy is a personal contract for which exemplary damages may be awarded.

After *Kewin*, the Court of Appeals issued *Shikany v Blue Cross & Blue Shield of Michigan*, which found a health insurance policy to be a commercial contract as well. However, the Court still recognized the personal contract exception:

"Here, the contract between plaintiff and defendant provided for the payment of certain medical expenses, a financial arrangement capable of accurate monetary recompense for any breach. We find that the hospitalization insurance contract is..."
Don’t call the conduct “bad faith”

Considering *Kewin* and its progeny, what does proving bad faith add to an insured’s recovery? The answer is that bad-faith conduct may form the basis of extra-contractual damages, but the claimant is better served by not using the term “bad faith.”

First-party claims

An insured aggrieved by conduct of an insurance company may consider claims for intentional infliction of emotional distress or negligent infliction of emotional distress. While there is no tort for bad-faith denial of insurance benefits, the emotional-distress torts make the underlying bad-faith conduct actionable and support damages beyond compensatory. However, the policyholder should appreciate the heightened burden imposed on emotional distress claims. If it were recognized, an independent tort of bad faith would carry a “preponderance of the evidence” burden, with a standard of “arbitrary, reckless, indifferent, or intentional disregard.”

Conversely, claims of intentional or negligent infliction of emotional distress require proof of “extreme or outrageous conduct” resulting in “extreme emotional distress.” Therefore, the insurer’s conduct must exceed ordinary “threats, insults, or indignities,” but if evidence of insurance company conduct and the resulting distress is legally sufficient, the insured is entitled to an award of extra-contractual damages.

Other strategies make use of bad-faith conduct without bringing an independent claim. Take, for example, *Isagholian v Transamerica Ins Co*, which involved a plaintiff who sued his homeowners insurance company for breach of contract and a separate claim for “bad-faith dealings.” The claim for bad-faith dealings was not actionable, but the Court permitted the jury to hear evidence of the insurer’s conduct, stating “[t]he good faith of both parties was integral to this action.” Although the insured did not expand the damages available to him, he strengthened the claim that went to the jury.

Evidence of bad faith has also been used to form the basis of fraud and related misrepresentation claims. Note that the burden for proving fraud is also heightened to clear-and-convincing evidence and must be pled with specificity. Finally, as previously discussed, the aggrieved insured may consider whether the alleged conduct violates the MCPA.

Third-party claims

Up to this point, we have focused on first-party disputes; however, there is a separate framework for determining bad faith when third-party tort claimants are involved. A recognized claim for bad faith arises when an insurance company refuses to settle a lawsuit that goes to trial and a verdict returns in excess of the policy limits.

Bad-faith failure to settle within policy limits is an exception to the general rule against awarding extra-contractual...
damages. The law recognizes the same definition of bad faith as first-party coverage, but when the insurance in dispute protects against third-party claims, additional remedies exist. The Michigan Supreme Court identified 12 non-exhaustive indicators of bad faith to consider when evaluating the conduct of an insurance company.43

As mentioned, the Uniform Trade Practices Act recognizes, defines, and penalizes bad faith. The insured cannot bring a private cause of action,44 but may be awarded statutory interest on late or withheld insurance benefits at 12 percent per annum. Interest begins to accrue 60 days following submission of the claimant’s satisfactory proof of loss. Griswold Props, LLC v Lexington Ins Co clarified the distinction between awarding first-party and third-party penalty interest on late or withheld insurance benefits at 12 percent per annum. The law recognizes the same definition of bad faith as first-party coverage, but when the insurance in dispute provides as third-party coverage, additional remedies exist. The Michigan Supreme Court identified 12 non-exhaustive indicators of bad faith to consider when evaluating the conduct of an insurance company.43

Conclusion

Bad-faith breach of an insurance contract, whether alleged as a tort or as part of a breach of contract action, is limited under Michigan law. Nevertheless, the doctrine of bad faith is not entirely outlawed and, depending on the particular policy of insurance and conduct of the insurer, an actionable claim or claims may be brought by an insured or other party entitled to benefits under Michigan law. Understanding how to navigate the framework governing bad faith is essential when drafting a complaint under Michigan law. ■

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ENDNOTES

2. Id. at 416.
5. Id. at 429-431.
10. MCI 500.301 et seq.
11. MCI 445.901 et seq.
12. See MCI 445.902(1)(g) (definition of “trade or commerce”).
18. Id.
19. Peterson Williams, Michigan Insurance Law and Practice (ICLE, 2018), Chapter 2, § 2.35 (“Exemplary damages are not recoverable for breach of a contract ‘absent allegation and proof of torturous [sic] conduct existing independent of the breach.’”).
22. Id. at 610, citing Stewart, 349 Mich at 471.
25. Id.
26. MCI 500.2001 et seq.
30. MCI 500.3101 et seq.
31. Commercial Union, 426 Mich at 137 (“If the insurer is motivated by selfish purpose or by a desire to protect its own interests at the expense of its insured’s interest, bad faith exists, even though the insurer’s actions were not actually dishonest or fraudulent,” citing Valentine v Liberty Mut Ins Co, 620 F2d 583 (CA 6, 1980) and Shearer v Reed, 286 Pa Super 188, 428 A2d 635 (1981)).
32. Isagholian, 208 Mich App at 11.
35. McCahill, 179 Mich App at 761 (the Court of Appeals upheld a $100,000 jury verdict against an insurance company for intentional infliction of emotional distress upon its insured).