



# Insurance “Bad Faith” Law After the Hurricanes

By Dean A. Sutherland

**T**he devastation of south Louisiana caused by Hurricanes Katrina and Rita has led to an unprecedented number of insurance claims.

Different statutes apply to different types of insurance policies. Claims for benefits for life insurance contracts are governed by La. R.S. 22:656. Health and accident claims are governed by La. R.S. 22:657. All other types of insurance policies are governed by La. R.S. 22:658 and La. R.S. 22:1220.<sup>1</sup>

Under certain circumstances, the Insurance Code allows an insured to recover damages, penalties and attorney’s fees from its insurer.<sup>2</sup> These statutory provisions are not uniform regarding the types of prohibited conduct or the potential penalties. This article reviews the statutory penalties that may be imposed on insurance companies for improper handling of first-party property insurance claims under La. R.S. 22:658 and La. R.S. 22:1220.

Duties Owed by Insurance Companies and Potential Penalties for Violation of Those Duties

## Types of Insurer Misconduct that Can Trigger Statutory Penalties

For all insurance policies (except life insurance, accident and health insurance or workers’ compensation), La. R.S. 22:658<sup>3</sup> and/or La. R.S. 22:1220<sup>4</sup> are applicable. The standard of insurer misconduct that may trigger the imposition of statutory penalties under La. R.S. 22:658(B)(1) and La. R.S. 22:1220

(B)(5)<sup>5</sup> is nonpayment that is “arbitrary, capricious or without probable cause.”

## Statutory Penalties

The La. R.S. 22:658 penalty for “all other” policies was amended in 2003 and again in 2006.<sup>6</sup> The 2006 amendment increased the penalty to:

fifty percent damages on the amount found to be due from the insurer to the insured, or one thousand dollars, whichever is greater . . . or in the event a partial payment or tender has been made, fifty percent of the difference between the amount paid or tendered and the amount found to be due.<sup>7</sup>

For statutory violations occurring after Aug. 15, 2006, attorney’s fees are recoverable.<sup>8</sup>

La. R.S. 22:1220(A) allows an insured to recover compensatory damages resulting from its insurer’s breach of its statutory obligations. Additionally, La. R.S. 22:1220(C) subjects the insurer to potential penalties “in an amount not to exceed two times the damages sustained or five thousand dollars, whichever is greater.”

## Penalties May Be Awarded Even Absent Proof of Actual Damages

La. R.S. 22:1220(C) penalties may be awarded for an insurer’s breach of La. R.S. 22:1220, even absent proof of actual damages caused by the insurer’s misconduct.<sup>9</sup>

The maximum penalty, when there is no proof of damages caused by the breach of the insurer’s duties under La. R.S. 22:1220, is \$5,000.<sup>10</sup>

## Overlap Between “Bad Faith” Penalty Statutes

Recognizing that La. R.S. 22:658(A)(1) and La. R.S. 22:1220(B)(5) overlap, *Calogero v. Safeway Insurance Company of Louisiana*, *supra*, affirmed the award of attorney’s fees pursuant to

the former version La. R.S. 22:658(B)(1) and of higher statutory penalties under La. R.S. 22:1220(C).

An insured may wish to assert penalty claims under both La. R.S. 22:658(B)(1) and La. R.S. 22:1220(C).

The two statutes have different time periods before the insurer’s inaction triggers potential penalties.<sup>11</sup> If the insurer violates its statutory obligations for more than 30, but less than 60, days after receiving a “satisfactory proof of loss,” only La. R.S. 22:658 is applicable.

The penalty provisions of La. R.S. 22:658(B)(1) are mandatory.<sup>12</sup>

The potential La. R.S. 22:1220(C)<sup>13</sup> penalties could be substantially greater than the penalties provided by La. R.S. 22:658(B)(1).<sup>14</sup>

## What Must An Insured Prove to Establish a “Bad Faith” Claim?

An insured seeking statutory penalties pursuant to La. R.S. 22:658(B)(1) and/or La. R.S. 22:1220(B)(5)/1220(C) must prove three things:

- ▶ the insurer received a satisfactory proof of loss;
- ▶ the insurer failed to pay the claim within the applicable statutory period; and
- ▶ the insurer’s failure to pay was arbitrary and capricious.<sup>15</sup>

For an insurer’s violation of any subpart of La. R.S. 22:1220(B), other than La. R.S. 22:1220(B)(5), proof that the insurer’s actions were “arbitrary, capricious or without probable cause” is unnecessary.<sup>16</sup>

## What is a “Satisfactory Proof of Loss?”

The phrase “satisfactory proof of loss” is not defined in any “bad faith” statute. No specific form or mandatory information is required.

The Louisiana Supreme Court has defined a La. R.S. 22:658 “satisfactory proof of loss” in an UM coverage claim as follows:

. . . the insured must show that the insurer received sufficient facts which fully apprise the insurer that (1) the owner or operator of the other vehicle involved in the accident was uninsured or under insured; (2) that he [or she] was at fault; (3) that such fault gave rise to damages; and (4) establish the extent of those damages.<sup>17</sup>

A less-demanding test is used in other “bad faith” claims. For example, a handwritten estimate of repairs on a fire-damaged residence was a satisfactory proof of loss under a homeowner’s policy.<sup>18</sup>

The inspection of the damaged property by an independent adjuster hired by the insurer is a “satisfactory proof of loss” under La. R.S. 22:1220(B)(5).<sup>19</sup>

## What Does “Arbitrary, Capricious or Without Probable Cause” Mean?

An insurer faces potential exposure to statutory penalties pursuant to La. R.S. 22:658(B)(1) and La. R.S. 22:1220(B)(5) when its failure to pay is “arbitrary, capricious or without probable cause.” While “bad faith” is a shorthand reference for “arbitrary, capricious or without probable cause,” the two phrases have different meanings.

In *Reed v. State Farm*, the Supreme Court explained that an insurer’s misconduct meets the “arbitrary, capricious or without probable cause” standard when the insurer’s actions are unjustified, lack a reasonable basis or are without probable cause or excuse.<sup>20</sup>

## Unconditional Tender

La. R.S. 22:658(A)(1) requires that:

[a]ll insurers issuing any type of contract [other than life, health and accident and workers’ compensation policies] shall pay the amount of any claim due any insured within thirty days after receipt of satisfac-

tory proofs of loss from the insured or any party in interest.

The payment must be unconditional and in an amount as to which reasonable minds cannot disagree.<sup>21</sup>

An offer of payment tied to a complete release of the insured's claim is not an unconditional tender required by La. R.S. 22:658.<sup>22</sup>

## Misrepresentation of Coverage

An insurer's denial of coverage may violate its obligations under La. R.S. 22:1220(B)(1). When an insurer refuses to pay a claim based on its interpretation of its policy's coverage, there is no "bright line" test to determine whether it violated La. R.S. 22:1220(B)(1). A denial based on a reasonable and legitimate dispute "as to the extent and causation of a claim" does not constitute bad faith.<sup>23</sup>

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However, an insurer that rejects a claim based solely on its misinterpretation of its policy's coverage may be liable for statutory penalties.<sup>24</sup>

In *McGee v. Omni Ins. Co.*,<sup>25</sup> the insurer violated La. R.S. 22:1220(B)(1) through its failure to keep the insured advised of the status of the litigation and its failure to communicate the "pertinent facts" to the insured. "**Misrepresentation can occur when an insurer either makes untrue statements to an insured concerning pertinent facts or fails to divulge pertinent facts to the insured.**"<sup>26</sup>

## Reasonable Investigation/ Loss Adjustment

An insurer may be liable for La. R.S. 22:658 and La. R.S. 22:1220 penalties if it fails to properly investigate a claim or to initiate a loss adjustment after it receives notice of the loss.

### Duty to Investigate Under La. R.S. 22:658

La. R.S. 22:658(A)(3) includes a duty to investigate.<sup>27</sup>

La. R.S. 22:658(A)(3) obligates the insurer to take "some substantive and affirmative step to accumulate the facts that are necessary to evaluate the claim."<sup>28</sup>

Merely opening a file does not comply with La. R.S. 22:658(A)(3).<sup>29</sup>

### Duty to Investigate Under La. R.S. 22:1220

Even though a property damage insurer timely begins to adjust a claim, it may be liable for La. R.S. 22:1220 statutory penalties for an insufficient investigation.<sup>30</sup>

## Defenses to Bad Faith Claims

Several potential defenses are available to an insurer facing a statutory penalty claim:

- ▶ A valid underlying claim must exist.<sup>31</sup>
- ▶ The refusal to pay was reasonable, even if wrong.<sup>32</sup>
- ▶ The insured withheld necessary information.<sup>33</sup>
- ▶ "Bad faith" depends on facts known

to the insurer on the date of the refusal to pay.<sup>34</sup>

- ▶ As "penal" statutes, La. R.S. 22:658 and La. R.S. 22:1220 are strictly construed.<sup>35</sup>

## Conclusion

Normally, an insurance company's denial of a first-party claim by its insured will not support a statutory "bad faith" penalty claim against the insurer. However, if an insurance company's violation of its statutory duties is unjustified, lacks a reasonable basis or is without probable cause or excuse, statutory penalties may be imposed.

## FOOTNOTES

1. Workers' compensation bad faith claims are governed by the workers' compensation law, La. R.S. 23:1021, *et seq.*

2. This article addresses private causes of action. The Unfair Trade Practices Act, La. R.S. 22:1214(14) and La. R.S. 22:1217, does not create a private cause of action to recover penalties. *Theriot v. Midland Risk Ins. Co.*, 95-2895 (La. 5/20/97), 694 So.2d 184, 189-193.

3. La. R.S. 22:658(C) applies to workers' compensation cases. La. R.S. 23:1201(I).

4. La. R.S. 22:1220(D) excludes only health and accident insurance policies from its coverage.

5. *See Sultana Corp. v. Jewelers Mut. Ins. Co.*, 03-0360 (La. 12/3/03), 860 So.2d 1112.

6. Acts 2003, No. 790, § 1. Acts 2006, No. 813 (effective 8/15/06).

7. La. R.S. 22:658(B)(1).

8. Between the effective dates of the 2003 and 2006 amendments to La. R.S. 22:658, attorney's fees were not recoverable.

9. *Sultana*, 860 So.2d at 1118-1119.

10. *Urrate v. Argonaut Great Cent. Ins. Co.*, 04-256 (La. App. 5 Cir. 8/31/04), 881 So.2d 787, 791-792, *writs denied*, 04-2644 (La. 1/7/05), 891 So.2d 686 and 04-2685 (La. 1/7/05), 891 So.2d 690; *Hollier v. State Farm Mut. Auto. Ins. Co.*, 01-0592 (La. App. 3 Cir. 10/31/01), 799 So.2d 793, *writ denied*, 01-3163 (La. 2/22/02), 810 So.2d 1135.

11. The time period under La. R.S. 22:658 is 30 days. The time period under La. R.S. 22:1220 is 60 days.

12. *See Sultana*, 860 So.2d at 1117. This portion of the opinion is *dicta*. The issue before the *Sultana* court was whether the insured must prove that it suffered damages as a result of the insurer's violation of La. R.S. 22:1220(B)(2), as a prerequisite for the award of penalties under La. R.S. 22:1220(C). The court did not

mention Reed, *supra*, decided six weeks earlier, in which the split between the lower courts as to whether La. R.S. 22:1220(C) penalties are mandatory or discretionary was noted.

13. In addition to any general or special damages to which a claimant is entitled for breach of the imposed duty, the claimant may be awarded penalties assessed against the insurer in an amount not to exceed two times the damages sustained or \$5,000, whichever is greater.

14. Violation under La. R.S. 22:1220(C) "shall subject the insurer to a penalty, in addition to the amount of the loss, of twenty-five percent damages on the amount found to be due from the insurer to the insured, or one thousand dollars, whichever is greater . . ."

15. Boudreaux v. State Farm Mut. Auto. Ins. Co., 04-1339 (La. App. 4 Cir. 2/2/05), 896 So.2d 230, 233.

16. Sultana, *supra*.

17. McDill v. Utica Mutual Ins. Co., 475 So.2d 1085, 1089 (La. 1985).

18. *See* Sevier v. U.S. Fidelity & Guar. Co., 86-0801 (La.11/24/86), 497 So.2d 1380, 1384 (as long as the insurer receives sufficient information to act on the claim, "the manner in which it obtains the information is immaterial").

19. Becnel v. Lafayette Ins. Co., 99-2966 (La. App. 4 Cir. 11/15/00), 773 So.2d 247, *writ denied*, 00-3458 (La. 2/9/01), 785 So.2d 827; Carter v. Safeway Ins. Co., 37,788 (La. App. 2 Cir. 10/29/03), 859 So.2d 279.

20. La. R.S. 22:658 and La. R.S. 22:1220 require proof that the insurer was "arbitrary, capricious, or without probable cause," a phrase that is synonymous with "vexatious." Both phrases describe an insurer whose willful refusal of a claim is not based on a good-faith

defense. *See* Reed, 857 So.2d at 1021.

21. Genusa v. Robert, 98-449 (La. App. 5 Cir. 10/14/98), 720 So.2d 166, 172-173; Patin v. Imperial Lloyds Ins. Co., 95-841 (La. App. 3 Cir. 1/17/96), 670 So.2d 238, 244. The La. R.S. 22:658A(1) unconditional tender requirement is not limited to UM claims. Dufrene v. Imperial Fire and Cas. Ins. Co., 03-1001 (La. App. 5 Cir. 2/10/04), 866 So.2d 380, *writ denied*, 04-0891 (La. 5/21/04), 874 So.2d 176; La. R.S. 22:658(B)(1); Carter, 859 So.2d at 285-286.

22. Hayes v. Allstate Ins. Co., 99-1558 (La. App. 3 Cir. 3/1/00), 758 So.2d 900, *writ denied*, 00-1587 (La. 8/31/00), 766 So.2d 1280.

23. Reed, 857 So.2d at 1021.

24. Dawson Farms, L.L.C. v. Millers Mut. Fire Ins. Co., 34,801 (La. App. 2 Cir. 8/1/01), 794 So.2d 949, at 953, *writs denied*, 01-2477 (La. 12/07/01), 803 So.2d 34 and 01-2497 (La. 12/07/01), 803 So.2d 37.

25. 02-1012 (La. App. 3 Cir. 3/5/03), 840 So.2d 1248, *writs denied*, 03-1375 (La. 12/12/03), 860 So.2d 1149 and 03-1382 (La. 12/12/03), 860 So.2d 1149.

26. McGee, 840 So.2d at 1256 (emphasis added).

27. Wallace v. State Farm Mut. Auto. Ins. Co., 36,099 (La. App. 2 Cir. 6/14/02), 821 So.2d 704, 713.

28. McClendon v. Economy Fire & Cas. Ins. Co., 98-1537 (La. App. 3 Cir. 4/7/99), 732 So.2d 727, 731.

29. Hollier v. State Farm Mut. Auto. Ins. Co., 01-0592 (La. App. 3 Cir. 10/31/01), 799 So.2d 793, *writ denied*, 01-3163 (La. 2/22/02), 810 So.2d 1135.

30. Clark v. McNabb, 04-0005 (La. App. 3 Cir. 5/19/04), 878 So.2d 677, 684.

31. Robin v. Allstate Ins. Co., 02-689 (La.

App. 3 Cir. 2/5/03), 844 So.2d 41, 46.

32. Kottle v. Provident Life and Acc. Ins. Co., 34,099 (La. App. 2 Cir. 12/15/00), 775 So.2d 64, 79, *writ denied*, 01-0490 (La. 4/20/01), 790 So.2d 635.

33. Boudreaux v. State Farm Mut. Auto. Ins. Co., 04-1339 (La. App. 4 Cir. 2/2/05), 896 So.2d 230.

34. Sutton v. Oncale, 99-967 (La. App. 5 Cir. 3/29/00), 765 So.2d 1072.

35. Vaughn v. Franklin, 00-0291 (La. App. 1 Cir. 3/28/01), 785 So.2d 79, *writ denied*, 01-1551 (La. 10/5/01), 798 So.2d 969; Bennett v. State Farm Ins. Co., 03-1195 (La. App. 3 Cir. 3/24/04), 869 So.2d 321, 328.

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