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PENNSYLVANIA SUPREME COURT ISSUES RULING ON INSURANCE BAD FAITH

Rancosky v. Washington National Insurance Company, Sept. 28, 2017

The Pennsylvania Supreme Court last month issued an opinion in which it, for the first time, clarified the contours of a bad-faith claim under 42 Pa. C.S.A. § 8371. This case, *Rancosky v. Washington Nat'l Ins. Co.*, addressed the following two issues:

> **"IN THIS DISCRETIONARY APPEAL, WE CONSIDER, FOR THE FIRST TIME, THE ELEMENTS OF A BAD FAITH INSURANCE CLAIM BROUGHT PURSUANT TO PENNSYLVANIA'S BAD FAITH STATUTE FOUND AT 42 PA.C.S. § 8371."**

1. Whether the Supreme Court should adopt the two-part test set forth in *Terletsky v. Prudential Prop. & Cas. Ins. Co.*, 649 A.2d 680 (Pa. Super. Ct. 1994) for establishing bad faith under § 8371; and

2. Whether, if the *Terletsky* standard is adopted, motive of self-interest or ill- will is a mandatory prerequisite to establishing a claim for bad faith under § 8371 or whether is merely a discretionary consideration.

The Supreme Court affirmed the *Terletsky* test for establishing bad faith under § 8371, and thus concluded that a showing of bad faith requires proof that: 1. the insurer did not have a reasonable basis for denying benefits; and 2. the insurer knew or recklessly disregarded its lack of a reasonable basis in denying the claim. It likewise concluded with little discussion that the first prong encompassed an objective inquiry into whether a reasonable insurer would have denied payment of the claim under the facts and circumstances presented. The

Pennsylvania courts have routinely applied *Terletsky* to bad-faith claims under § 8371, and, despite the confusion created by *Terletsky* as to whether an insurer's improper motive is a prerequisite showing, the Superior Court has subsequently clarified that *Terletsky* did not establish an insurer's improper motive as a necessary element. *See Greene v. United Servs. Auto. Ass'n*, 936 A.2d 1178, 1190 (Pa. Super. Ct. 2007); *Nordi v. Keystone Health Plan West, Inc.*, 989 A.2d 376, 384-85 (Pa. Super. Ct. 2010). As such, *Rancosky* appears to affirm what has already been a growing trend in Pennsylvania law.

subjective motivations of the insurer in denying the particular claim at issue are not relevant to this inquiry.

Turning to whether *Terletsky*'s second prong required proof of the insurer's improper motive, *Rancosky* reviewed the history of bad-faith claims in Pennsylvania. This historical development began when the Supreme Court declined to judicially create a bad faith claim in 1981, instead leaving the matter to the legislature. *See D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 494 Pa. 501, 431 A.2d 966 (1981). The Pennsylvania legislature responded to *D'Ambrosio* when it passed § 8371 in 1990, and *Rancosky* thus concluded that the legislature intended to incorporate *D'Ambrosio*'s understanding of bad faith into the statute.

D'Ambrosio understood bad faith to require an insurer's knowing *or* reckless disregard of the lack of a reasonable basis to deny benefits. Although punitive damages were specifically requested in *D'Ambrosio*, this case made no reference to the higher threshold for obtaining punitive damages when describing bad faith. Thus, *D'Ambrosio* did not establish that a higher threshold was necessary to obtain punitive damages under § 8371. Likewise, § 8371 offers no basis to require a higher showing for punitive damages, as it puts punitive damages on the same footing as other categories of damages. It does not distinguish between "bad faith" generally and "bad faith" allowing for punitive damages, but simply states a court may, upon a finding of bad faith, award interest, punitive damages, and/or court costs and counsel fees. Finally, *Rancosky* concluded that requiring proof of an improper motive would limit recovery in any bad-faith claim to only those most egregious instances in which the insured uncovered a "smoking gun."

As such, *Rancosky* concluded that the *Terletsky* test establishes the standard for determining bad faith under § 8371, and that an insured does not have to prove an insurer's motive of self-interest or ill-will in order to recover thereunder. Thus, to prove bad faith under § 8371, an insured need only prove that: 1. the insurer did not have a reasonable basis for denying benefits; and 2. the insurer knew or recklessly disregarded its lack of a reasonable basis in denying the claim. Evidence of an insurer's improper motive, though not required, will serve as evidence that the insurer knowingly or recklessly disregarded the lack of a reasonable basis to deny benefits.

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The most important development in *Rancosky*, however, is that a finding of bad faith under § 8371 is sufficient to support an award of punitive damages, regardless of whether the insured is able to prove an improper motive on the part of the insurer. Thus, an insured's burden of proof under § 8371 remains the same for all insureds, and the insured that cannot prove an improper motive may nonetheless be entitled to punitive damages.

We would be happy to provide you with a copy of the Supreme Court's opinion upon request. As always, please feel free to contact us with any questions or concerns.