Rancosky Adopts *Terletsky*: Pennsylvania Supreme Court Sets Standard for Statutory Bad Faith Claims

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Earlier today, in a case of first impression, the Pennsylvania Supreme Court adopted the *Terletsky* two-part test for proving a statutory "bad faith" claim under 42 Pa. C.S.A. § 8371, which requires that a plaintiff present "clear and convincing evidence (1) that the insurer did not have a reasonable basis for denying benefits under the policy and (2) that the insurer knew of or recklessly disregarded its lack of a reasonable basis." *Rancosky v. Washington National Insurance Company,* No. 28 WAP 2016 (Pa. Sept. 28, 2017). The court further ruled that proof of an insurer's "subjective motive of self-interest or ill-will," while potentially probative of the second prong of the test, is not a requirement to prevail under § 8371. Evidence of an insurer's "knowledge or reckless disregard for its lack of a reasonable basis" for denying a claim alone, according to the court, is sufficient even in cases seeking punitive damages.

This is the first time the Supreme Court has announced the standard for proving statutory bad faith in Pennsylvania. When the Pennsylvania legislature created this cause of action 27 years ago, it did so without explaining what "bad faith" means or what proofs are required under § 8371. The statute provides:

> **§ 8371. Actions on insurance policies.**
>
> In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:
>
> 1. Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
>
> 2. Award punitive damages against the insurer.
>
> 3. Assess court costs and attorney fees against the insurer.

Thus, before today, a series of decisions by the Pennsylvania Superior Court, originating with *Terletsky v. Prudential Property & Casualty Insurance Company,* 649 A.2d 680 (Pa. Super. 1994) and its two-part test, were the law of the land on what would be required to prove a § 8371 claim. Pennsylvania courts, including *Terletsky,* frequently cited to the *Black's Law Dictionary* definition of bad faith, which contemplates "conduct [that] imports a dishonest purpose and means a breach of a known duty (*i.e.* good faith and fair dealing), through some motive of self-interest or ill will. . . ." Over the years, insurers referred to that definition in § 8371 jurisprudence as the measure by which these cases were to be judged.

While the Supreme Court opinion in *Rancosky* suggests otherwise, there has been uneven treatment of the issue in Superior Court decisions since *Terletsky.* For example, in *Brown v. Progressive Insurance Company,* 860 A.2d 493 (Pa. Super. 2003), the Superior Court explained that "[t]o support a finding of bad faith, the insurer's conduct must be such as to 'import a dishonest purpose.' In other words, the plaintiff must show that the insurer breached its duty of good faith through some motive of self-interest or ill will." In *Greene v. United Services Automotive Association,* 936 A.2d 1178 (Pa. Super. 2007), on the other hand, the Superior Court referred to the "seemingly additional requirement" of proving a motive of self-interest or ill-will and held that it is not a "third element required for a finding of bad faith, but is probative of the second element identified in *Terletsky, i.e.,* 'the insurer knew or recklessly disregarded its

lack of a reasonable basis in denying the claim.'" Nevertheless, the Superior Court in *Greene* affirmed the trial court's conclusion that the insurer in that case did not act in bad faith because the evidence showed that the insurer "did not act with a motive of self-interest or ill-will."

In *Rancosky*, which involved a dispute over benefits under a cancer insurance policy, the Pennsylvania Superior Court, relying on *Greene*, determined that the trial court had incorrectly required proof of a "dishonest purpose" or "motive of self-interest or ill-will" and, instead, regarded this as a factor that may be considered in determining the second prong of the *Terletsky* test. The Supreme Court adopted this framework in *Rancosky*. In doing so, it concluded that neither its earlier (pre-§ 8371) decisions on the nature of bad faith nor the legislature purported to require a showing of ill will to recover punitive damages in these cases. Imposing such a requirement, the court said, would "limit recovery in any bad faith claim to the most egregious instances" and could "functionally write bad faith under Section 8371 out of the law altogether."

Until now, there was no definitive pronouncement from the Supreme Court as to what constitutes bad faith in Pennsylvania. Now that it is clear that a showing of ill will is not required, policyholders may interpret today's decision as facilitating § 8371 claims. While the long term impacts remain to be seen, the potential exists for *Rancosky* to blur the critical line between ordinary negligence, which is not actionable, and the threshold reckless conduct required for bad faith. This raises an understandable concern given the harsh penalties insurers face under the statute, such as exposure to punitive damages.

The encouraging news is that some safeguards are already in place that should help filter out non-meritorious cases. At least in Pennsylvania state court, for example, there is no right to a jury trial in § 8371 cases (though a jury may still decide a policyholder's breach of contract claims). Additionally, the Supreme Court reiterated in *Rancosky* that plaintiffs must prove bad faith by "clear and convincing" evidence.

That heightened evidentiary standard applies to the required foundational showing that an insurer lacked a reasonable basis to deny policy benefits. The defense of "reasonableness" therefore remains intact.

Even so, factfinders may have difficulty differentiating between potential bad faith conduct and ordinary mistakes, inadvertence, *etc.* This is especially so in borderline situations. There is a further risk in federal court, where these cases may be tried to a jury, that a factfinder may apply a lesser evidentiary standard.

Dispositive and other motions are thus poised to become even more important tools to protect insurers against erroneous findings of bad faith liability. They present a crucial opportunity to emphasize that "bad judgment is not bad faith" and that negligence in whatever form never has been and still is not enough to make out an extra-contractual liability case.

If you have questions or would like additional information, please contact John Anooshian (anooshianj@whiteandwilliams.com; 215.864.7005), Sean Mahoney (mahoneys@whiteandwilliams.com; 215.864.6342) or another member of our Insurance Coverage and Bad Faith Group.