MARYLAND'S FIRST PARTY BAD FAITH STATUTE

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On October 1, 2007, a new law became effective in Maryland that, for the first time, permits insureds with first party property claims to sue their insurers for failing to act in good faith. The law, which Governor Martin O'Malley signed on April 24, 2007, did three things. First, it created a cause of action enabling policyholders to sue their insurers for failure to act in good faith in settling a first party claim under a property and casualty insurance policy. Second, it amended Maryland's Unfair Claims Settlement Practices Act to include as an unfair claims settlement practice the failure of an insurer to act in good faith in deciding first party property claims. Third, the law set forth the procedure an insured must follow to prosecute the claim.

The new cause of action, which is found in Maryland Code, Insurance Article §3-1701, applies to actions to determine whether coverage exists in the first place, or the extent to which the insured is entitled to recover for a covered loss. Under either scenario, the insured must allege that the insurer has failed to act in good faith, ***and*** seek (1) actual damages, (2) litigation costs and expenses and (3) interest. An insured who proves his or her claim may recover actual damages (not to exceed policy limits), expenses and costs, including reasonable attorneys' fees (not to exceed 1/3rd the amount of actual damages recovered) and interest. An insurer will not be found to have failed to act in good faith based solely on delay in determining coverage or amount of payment for a covered loss if the insurer acts within a time specified by a statute or regulation.

Acts that violate §3-1701 now constitute violations of Maryland's Unfair Claims Settlement Practices Act, Maryland Code, Insurance Article §§27-303(9) and 27-304(18). In other words, it is an unfair settlement practices act for an insurer to fail to act in good faith in settling a first party property or casualty claim, either on one occasion or with such frequency as to indicate a general business practice. The law empowers Maryland's Insurance Commissioner to impose a penalty of not more than $125,000 for each violation of the Unfair Claims Settlement Practices Act, or applicable regulations. The Commissioner may also order as restitution the damages recoverable under §3-1701.

The new bad faith law does not limit a party's right to file a civil action for damages or other legal remedies. However, an insured must follow an administrative procedure before electing a jury trial[1]. This procedure, which is found at Maryland Code, Insurance Article §27-1001, requires an insured to file a complaint with the Maryland Insurance Administration (MIA). The complaint must include all documents the insured submitted to the insurer as proof of the loss, specify applicable coverage and the amount of the claim, and state the amount of actual damages and costs.

The MIA will forward a copy of the insured's complaint to the insurer. This triggers a thirty (30) day period in which the insured must submit a written response to the complaint. The response must attach copies of each document from the claims file that will enable the MIA to reconstruct the insurer's activities on the claim in question. These documents include each pertinent communication, transaction, note, work paper, claim form, bill or explanation of benefits on the claim. The insurer must serve a copy of its response with attachments to the insured.

[1] An insured need not follow the procedure if the matter is within the small claims jurisdiction of the state District Court, if the parties agree to waive the requirement or if the action applies to a commercial insurance policy on a claim involving an applicable liability limit exceeding $1,000,000.

Under the applicable regulations, an insurer may withhold from its production to the insured documents it believes are privileged or are otherwise protected by law from disclosure. The insurer must provide the insured with an index, analogous to a privilege log, that describes the withheld documents. The MIA will make an *in camera* inspection of the withheld documents and determine whether the insurer must disclose them. If the MIA rules the insurer must disclose them, the MIA shall consider that the insurer withheld them when rendering its decision on the claim.

These regulations have grave implications for insurance companies concerning materials it believes are privileged or otherwise protected. The MIA *in camera* review is not conducted by a trial judge, and complying with an MIA order to produce a document arguably waives a privilege that a Circuit Court judge may otherwise find exists. In addition, an insurer may believe in good faith that it is withholding such materials only to be punished for doing so if the MIA disagrees with the insurer's position. It remains to be seen how these issues will play out, but I anticipate they will be hotly litigated for the next few years.

The MIA must, within ninety (90) days after it receives the filing, render a decision that determines:

1. Whether coverage exists under the first party property or casualty claim;
2. The amount of actual damages to which the insured is entitled;
3. Whether the insured breached its obligation to pay the claim;
4. Whether the carrier acted in good faith in so breaching; and
5. The amount of the damages award.

The law deems a failure of the MIA to render its decision within ninety (90) day period to be a decision in the insurer's favor on the bad faith and breach issues. Either way, this event brings the parties to the next step in the administrative process.

A party who feels aggrieved by the MIA's decision has thirty (30) days to request an administrative hearing. An MIA administrative law judge hears the matter *de novo*, and the ALJ's ruling is considered a final decision on the claim. A failure to request a hearing within the thirty days renders the MIA's decision final.

A party may appeal the MIA's decision, or a decision of the ALJ, to a Circuit Court. A Circuit Court judge likewise hears the matter *de novo*. In cases that involve two or more insureds, where one requests a hearing and one appeals to the Circuit Court, the matter is transferred to Circuit Court and the hearing matter is consolidated with the Circuit Court appeal.

Maryland's legislature, the General Assembly, for years tried, without success, to pass legislation creating such a cause of action. Two events set the ball in motion to make the new law a reality. First, in September 2003, Hurricane Isabel hit the mid-Atlantic region and caused an enormous amount of property damage in Maryland. Many Maryland policyholders believed that the insurance companies were not paying their Isabel claims fairly or were unfairly denying coverage outright. Second, Hurricane Katrina's devastation of the gulf coast states brought renewed focus on the issue of first party property and casualty claims, enabling the law's proponents to pass the legislation.

In March 2007, Governor O'Malley wrote the Chairman of the state House Judiciary Committee to support passage of the legislation, arguing that the "bill will reduce litigation, as it will encourage insurers to make fair offers, in good faith, and not force policyholders to pursue litigation to collect what is due to them." Insurance companies have valid reasons to

decline coverage on some claims, and, contrary to the Governor's assertion, this new law gives policyholders incentive to sue their carriers for claims that are denied. So, will the new law discourage or encourage litigation? The answer should become apparent in the next few years as Maryland wades into the new waters of first party bad faith.