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Oregon State Legislature
Oregon State Capitol
Senate Committee on Judiciary
900 Court Street NE
Salem, OR 97301

Re: House Committee on Business & Labor
March 10, 2021 Hearing on HB 3171 and HB 3272
State Farm Insurance Companies' Written Testimony in Opposition

Chair Holvey, Vice-Chair Bonham, Vice-Chair Grayber, and Members of the Committee:

Thank you for considering State Farm Insurance Companies' written testimony in opposition to HB 3171 and HB 3272. These bills have one purpose: to create in Oregon a right to a "second lawsuit" similar to what the California Supreme Court created in its 1979 *Royal Globe v. Superior Court*[1] decision, and then repudiated nine years later in *Moradi-Shalal v. Fireman's Fund Ins. Companies*[2]. In California, the result was increased lawsuits that overwhelmed the courts, a rise in fraud-related insurance claims, and higher rates for consumers—a decade of dysfunction.

I. What These Bills Do

Insurance Practices. HB 3272 is broad-reaching and uses this summer's terrible wind-driven wildfires, which unfortunately impacted several thousand Oregonians, to suggest that insurers are not handling claims adequately. According to the Division of Financial Regulation, it has closed 81 wildfire complaints, and only 8 of them were confirmed. Remembering that this summer and fall was a perfect storm of events across the country—floods and hurricanes in the South and East, wind and rain in the Midwest, and fires out West, and all aggravated by the travel and work restrictions imposed by COVID-19—the Insurance Industry has done a remarkable job responding. So far, State Farm, with around 21% of the homeowners' insurance market[3], has closed over 2,200 claims and paid out more than $230,000,000 for various claims including residential and commercial property, personal and commercial auto, and business interruption. While more severe claims remain open and homes are being rebuilt, insurers continue to pay policyholders alternative living expense (ALE) benefits. Given the nature of this event, this will be a relatively long process, but insurers remain committed to being there for their customers.

- **Bad Faith.** This is the crux of this bill. It creates a cause of action for alleged violations of Oregon's Unfair Claims Practices Act (UCPA) that allows for treble damages and

[1] 23 Cal.3d 880, 153 Cal.Rptr. 842, 592 P.2d 329 (1979).
[2] 46 Cal.3d 287, 250 Cal.Rptr. 1167, 58 P.2d 58 (1988).
[3] Division of Financial Regulation, Top 25 insurers in Oregon in 2019.

attorneys' fees. This type of legislation will drive up insurance rates, and is unnecessary because consumers already have adequate remedies under existing Oregon law. ORS 742.061 provides that if an insured sues on a claim and recovers more than was offered by the insurer, the court shall tax reasonable attorneys' fees as costs. In addition, consumers may use the complaint and restitution process created in 2013 (ORS 731.256).

- **Non-Bad Faith Provisions.** Many of these proposals are drawn from California legislation passed to address perceived issues following the 2015 and 2017 wildfires. Although they appear to promote consumer interests, the Legislature should balance the questionable benefit against the premium increases that must follow to pay for them.

  This bill requires insurers to allow 36 months to claim replacement cost and ALE benefits after a "major disaster" claim. Most insurers, including State Farm, now provide up to 24 months. It is now just about six months since the September fires, leaving 18 more months. Many of the things in California that seemed to necessitate this change do not exist in Oregon, and it seems unlikely that this change is needed. Nevertheless, if this greater coverage is mandated, insurers will have to rate for it; the Legislature should consider whether to force consumers to buy more insurance than they really need.

  HB 3272 will also require insurers to provide a new replacement cost estimate (RCE) every other year at renewal. This arose out of a perception that some consumers in California appeared to be underinsured following the 2015 and 2017 fires. So far, these issues have not surfaced in Oregon, and the fact is, insureds may currently request a RCE at any time. It, cannot, however, be calculated adequately without the insured's participation because only the insured knows the property and whether any structures have been added or changed. This is really unneeded legislation.

  Even though many policies already do, this bill will require insurers to allow full replacement cost if the insured decides to rebuild in another location or purchase an existing structure. Consumers need only shop around to find the coverage they need. Finally, it requires that policies permit the insured to combine payments up to the policy limits for coverages related to rebuilding the dwelling and other structures. This again, seems to be an issue that has not arisen in Oregon, and the insured can address this by purchasing the appropriate coverage amount.

UTPA. HB 3171 adds insurance unfair claims settlement practices to the definition of real estate, goods and services that are subject to penalties under the UTPA. It will allow any person claiming an "ascertainable loss", based upon existing prohibited practices set forth in the UTPA, or a claimed violation of an Unfair Claims Practice Act (UCPA) standard in the Insurance Code (ORS 746.230), to sue an insurer, a claim representative, or an insurance agent. It permits an individual to recover the greater of actual damages or $200, punitive damages, "appropriate" equitable relief, and attorneys' fees.

Under both bills, the newly authorized lawsuits will not be for contractual benefits at issue in an underlying insurance dispute. They will instead be "extra-contractual" causes of action, that can

be brought by first or third parties claiming additional consequential damages, punitive or treble damages, attorneys' fees, and "equitable relief."

As this Committee contemplates the changes to Oregon Law if either HB 3171 or HB 3272 passes, it should carefully consider each bill's anticipated effect on the Oregon insurance market. There is an irrefutable relationship between insurers' exposure to extra-contractual lawsuits (premised upon allegations of unfair claims handling), and higher insurance costs that consumers pay in those states that allow them.[4] State Farm respectfully asks legislators to step-back and consider whether Oregon's laws and judicial system already provide adequate remedies to ensure fair recovery of benefits and damages.

II. Insurance: a Highly Regulated Industry

Why shouldn't insurance be included in the Unlawful Trade Practices Act (UTPA) (HB 3171) like other businesses, or subject to private regulation under the Unfair Claims Practices Act (UCPA) (HB 3272)? The answer is simple: insurance has its own regulator and is already subject to a robust regulatory regime. The Oregon Insurance Code (ORS Title 52) has fourteen chapters regulating every aspect of the insurance industry; OAR Chapter 836 has 37 divisions of regulations that further define the duties and obligations of insurance companies from policy forms to rates to sales practices to claims handling.

Before an insurance policy can be sold to the public, the Insurance Division must first approve the form.[5] Before an insurer can issue the policy, it must file the rates with the Director of the Department of Consumer and Business Services (DCBS)[6], and the rates cannot be "be excessive, inadequate or unfairly discriminatory."[7] Producers that sell the policies must apply for the license and meet the criteria,[8] pass an examination,[9] and then obtain and maintain the license.[10]

The claims process is highly regulated by both the Insurance Code and Administrative Rules,[11] and the DCBS Director has broad authority to enforce Title 56, in general, and ORS 746.230 in

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[4] See, *e.g.*, William G. Hamm, Jeannie Kim. Rebbecca Reed-Arthurs, *The Impact of Bad Faith Lawsuits on Consumers In Florida and Nationwide*, U.S. Chamber of Commerce's Institute for Legal Reform, (September 15, 2010), Berkeley Research Group, available on line at http://www.bizjournals.com/tampabay/pdf/william_hamm_study_-_the_impact_of_bad_faith_lawsuits_on_consumers_in_florida%5B1%5D.pdf; *Third Party Causes of Action: Effects on West Virginia Insurance Markets,* Office of the Insurance Commissioner, February 2005, available on line at http://www.wvinsurance.gov/Portals/0/pdf/reports/third_party_causes_action_effects.pdf; Angela Hawken, Stephen Carroll, and Allan Abrahamse, *The Effects of Third-Party, Bad Faith Doctrine on Automobile Insurance Costs and Compensation* (Rand Institute for Civil Justice, 2003), available on line at http://www.rand.org/pubs/monograph_reports/MR1199.html.

[5] ORS 742.003.

[6] ORS 737.205.

[7] ORS 737.310.

[8] ORS 744.059.

[9] ORS 744.058.

[10] ORS 744.053.

[11] ORS 746.230; OAR, Ch. 836, Div. 80. In particular, OAR 836-080-0235 and 836-080-0240 outline strict requirements for claims processing and handling.

particular. During the 2013 Legislative Session, the Director was granted additional powers to seek restitution for consumers.[12]

The Director can examine insurers and their practices at any time,[13] and may institute enforcement proceedings[14] or request the Attorney General to so.[15] Even though the Director retains the professionals—appraisers, independent actuaries, independent certified public accountants or other specialists—the insurer being examined must pay for their services and other expenses.[16]

III. The California *Royal Globe* Experience

What happened in California during the decade following *Royal Globe* is best summed up by the California Supreme Court in *Moradi-Shalal*:

> Confirming Justice Richardson's prediction in his *Royal Globe* dissent, several commentators have observed that the rule in that case promotes multiple litigation, because its holding contemplates, indeed encourages, two lawsuits by the injured claimant: an initial suit against the insured, followed by a second suit against the insurer for bad faith refusal to settle. (Comment, supra, 12 Sw.U.L.Rev. at p. 125; Price, supra, 31 Hastings L.J. at pp. 1186.) As a corollary, *Royal Globe* may tend to encourage unwarranted settlement demands by claimants, and to coerce inflated settlements by insurers seeking to avoid the cost of a second lawsuit and exposure to a bad faith action. (Price, supra, 31 Hastings L.J. at pp. 1186–1187; Note, supra, 7 Pepperdine L.Rev. at pp. 790–791; Allen, supra, 13 Pacific L.J. at p. 851.)
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> Thus, one author observed, "One result of this decision is that every time a demand is now made to settle a lawsuit, an additional demand is likely to be forthcoming to coerce higher settlements. The demand now carries the threat that, unless settlement is immediate, a separate suit will be filed for violation of the Unfair Practices Act. The public ultimately will be affected by the additional drain on judicial resources. Moreover, the public will indeed suffer from escalating costs of insurance coverage, a certain result of inflated settlements and costly litigation." (Price, supra, 31 Hastings L.J. at p. 1186.)
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> Other commentators agree that *Royal Globe,* and its allowance of a direct action against the insurer, may result in escalating insurance costs to the general public resulting from insurers' increased expenditures to fund coerced settlements, excessive jury awards and increased attorney fees. (Allen, supra, 13 Pacific L.J. at p. 851; Note, supra, 7 Pepperdine L.Rev. at pp. 792–793; Note, supra, 15

[12] ORS 731.256.
[13] ORS 731.236; 731.300.
[14] ORS 731.256.
[15] ORS 731.258.
[16] ORS 731.302.

> Sw.U.L.Rev. at p. 393.) As stated by one writer, "The increased settlement costs required to settle the actual lawsuit and the potential one that hovers over most litigation involving an insured defendant will obviously result in higher premiums. In addition, those insurers that have the courage to refuse settlement where they do not feel it is warranted will necessarily be the subject of additional litigation because they will not in all instances have guessed correctly regarding the value of the case. When they have guessed incorrectly, *Royal Globe* encourages lawsuits against them." (Allen, supra, 13 Pacific L.J. at p. 851.)
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> Most authors have noted another unfortunate consequence of our holding in *Royal Globe* that insurers owe a direct duty to third party claimants: It tends to create a serious conflict of interest for the insurer, who must not only protect the interests of its insured, but also must safeguard its own interests from the adverse claims of the third party claimant. This conflict disrupts the settlement process and may disadvantage the insured. (Allen, supra, 13 Pacific L.J. at p. 851; Price, supra, 31 Hastings L.J. at pp. 1183–1184; Note, supra, 7 Pepperdine L.Rev. at pp. 791–792; Note, supra, 15 Sw.U.L.Rev. at p. 393.)[17]

During the decade following *Royal Globe*, Justice Richardson's concerns were indeed realized. Nearly every claim settlement demand included the standard *Royal Globe* letter reminding the insurer of its obligations under that case and threatening a subsequent law suit if the demands were not met. The impact on insurance consumers was predictable and real.

A. The Court System

Because of *Royal Globe*, the settlement value of minimal claims increased significantly, making even minor injury claims more likely to be litigated. Indeed, automobile personal injury suits nearly doubled between 1982 and 1987, "reaching as many as 91,450 cases, and then tumbled between FY89 and FY98, resulting in a loss of 33,100 cases."[18]

> In 1979, *Royal Globe Ins. Co. v. Superior Court* gave third parties injured by a policyholder a claim against the insurance company on the basis of "bad faith." The number of bad-faith claims filed jumped immediately after *Royal Globe,* as did the amounts paid by insurance companies to settle the underlying claims. The greater payouts made smaller claims more economical for attorneys to handle. This fact may account for some of the increase in the 1980s.
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> In 1988, *Royal Globe* was reversed in *Moradi-Shalal v. Fireman's Fund Ins. Cos*., and the economics of tort litigation again changed. By 1992, payments by insurance companies to claimants were 29% lower than might have been expected based on the payouts in the *Royal Globe* era. By 1997, payouts were 35% lower.

[17] *Moradi-Shalal*, pp. 301-302. Emphasis added.
[18] Report from the Center for Court Research, Innovation, and Planning, California Administrative Office of the Courts, 2003, *Exploring the Work of the California Trial Courts: a 20-Year Retrospective*, p. 43; available on line at http://www.courts.ca.gov/7808.htm.

> This change likely resulted in a decline in representation for people with smaller claims and, possibly, a decline in filings.[19]

These increased filings impacted courtroom availability, creating a backlog, particularly in Los Angeles, where it was nearly impossible to get to trial in less than five years.

B. Increased Fraud

Following *Royal Globe*, claims behavior changed dramatically. Some involved outright fraud where even very minor accidents with little or no damage resulted in bodily injury (BI) claims. In the year prior to *Royal* Globe, the ratio of BI to property damage (PD) claims was about 43% higher in California than in other states—in California, 30% of PD claims included BI; in other states, 21%. In the decade following *Royal* Globe, the ratio in California climbed to 46%, while in other states it rose to only 27%, a difference of 70%.[20] For some reason, drivers in California were more "fragile" than those in other states during the *Royal* Globe era.

The threat of a subsequent *Royal Globe* action also inflated claims and changed claims handling behavior. In the years prior to *Royal Globe*, the trend in average BI compensation was generally the same as in other tort states, and to the extent there was a difference, average BI compensation was falling compared to other states. *Royal Globe* reversed this, causing significant increases in BI claims payments. But, with the *Moradi-Shalal* decision, California experienced significant decreases in BI compensation compared to most other tort states.[21]

The types of claims made under *Royal Globe* that would not have been brought otherwise were typically low-speed rear-enders with little or no property damage. Significantly, the frequency of BI claims caused BI total payments to increase, even though the average per claim BI payment decreased.[22] Handling and litigating more BI claims increased costs unnecessarily, driving up insurance premiums. When the CA Supreme Court overruled *Royal Globe*, this aberrant claiming (and claims handling) behavior returned to normalcy, causing the gap between California and other tort states to essentially disappear.[23]

C. Higher Insurance Rates

It is really a matter of simple math, increased suits and commensurate litigation costs, plus more claims with higher severity, must result in higher insurance premiums, and in California they did: *Royal Globe* increased BI liability premiums from 32% to 53%.[24] A legislatively imposed system in Oregon as mandated by HB 3171 or HB 3272 would have a similar result.

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[19] *Ibid.*, p. vii.
[20] Angela Hawken, Stephen Carroll, and Allan Abrahamse, *The Effects of Third-Party, Bad Faith Doctrine on Automobile Insurance Costs and Compensation* (Rand Institute for Civil Justice, 2003), p. 26; available on line at http://www.rand.org/pubs/monograph_reports/MR1199.html.
[21] *Ibid.*, pp. 18, 27.
[22] *Ibid.*, p. 27.
[23] *Ibid.*, p. 38.
[24] *Ibid.*, p. 52.

Oregonians don't need these bills, and they don't want the higher insurance rates they would bring. In a 2015 polling study by DHM Research, 69% of voters said they believe they are adequately protected against unfairly denied claims by the existing regulatory system. Indeed, 91% of voters that filed insurance claims within the last five years believed their insurance company handled the claim fairly. Finally, 75% of the voters polled do not want to pay higher insurance premiums for an additional recourse against their insurance company.

IV. Conclusion

The existing regulatory system is working pretty well, and there is simply no evidence that there is a need for these bills. As the California experience showed, any potential benefits are likely to be far out-weighed by the negative impact on consumers because of decreased court access, increased fraud, and higher insurance premiums.

Thank you for considering this written testimony.

Respectfully submitted,

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