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TORT AND INSURANCE LAW

CRS §§ 10-3-1115 and -1116: Providing Remedies to First-Party Claimants

by Erin Robson Kristofco

Tort and Insurance Law articles provide information concerning current tort law issues and insurance issues addressed by practitioners representing either plaintiffs or defendants in tort cases. They also address issues of insurance coverage, regulation, and bad faith.

Coordinating Editor

William P. Godsman of the Law Office of William Godsman, Denver—(303) 455-6900, wgodsman@qwestoffice.net

About the Author

Erin Robson Kristofco is of counsel at Horowitz & Burnett, P.C.—(303) 996-8609, ekristofco@hblegal.net. She dedicates much of her practice to insurance litigation, including bad faith and plaintiff and defense coverage work under various types of insurance policies.

This article discusses CRS §§ 10-3-1115 and -1116, which provide remedies—including two times the covered benefit, court costs, and attorney fees—to certain first-party insurance claimants when their insurer has unreasonably delayed or denied payment of benefits.

Before August 2008, insureds in Colorado wrongfully denied insurance benefits largely relied on lawsuits alleging claims for breach of contract, breach of the covenant of good faith and fair dealing (the common law tort of bad faith), and requests for exemplary damages as a means of redress against their insurance companies. In August 2008, Colorado House Bill 08-1407 became effective. The new statutes are codified at CRS §§ 10-3-1115 and -1116 and provide remedies to certain first-party insurance claimants,

including recovery of two times the covered benefit, attorney fees, and court costs.

The statutes are noteworthy to insurance companies because, for the first time in Colorado, insurers may be liable for twice the covered amount and their insured's attorney fees, even without the insured showing willful and wanton actions as required for punitive damages. The statutes are noteworthy for insureds who, faced with the possibility of breaking even in many cases—that is, spending $50,000 on attorney fees in litigation only to recover $50,000 in insurance proceeds on the original covered claim—may have decided to forego litigation. Now, suits against insurers for unreasonable denial of covered benefits make more economic sense, because insureds may recover double the claim amount owed and recoup costs and attorney fees incurred in the process.

This article provides a general overview of the statutes. It discusses their applicability and how claims under the statutes differ from common law bad faith claims. It also summarizes relevant case law. The Article "CRS §§ 10-3-1116, ERISA Preemption, and the Standard of Review," which appears on page 75 of this issue, provides a detailed discussion of the preemption of state law causes of action under the Employee Retirement Income Security Act of 1974 (ERISA).

Applicability of the Statutes

The statutes apply only to certain types of first-party insurance claims. Some types of insurance are excluded by the statutes.

First-Party Claims

CRS § 10-3-1115 defines a "first-party claimant" as:

> an individual, corporation, association, partnership, or other entity claiming an entitlement to benefits owed directly to or on behalf of an insured under an insurance policy. A first-party claimant includes a public entity that has paid a claim for benefits due to an insurer's unreasonable delay or denial of the claim.[1]

A first-party claimant is an insured seeking coverage under his or her own policy. A first-party claimant does not include: "[a] nonparticipating provider performing services[] or [a] person asserting a claim against an insured under a liability policy."[2]

Types of Insurance

The statues exclude several specific types of insurance. The statutes do not apply to workers' compensation insurance.[3] The statutes also do not apply to title insurance claims.[4] CRS § 10-3-1115 states the statutes do not apply to life insurance;[5] however, § 1116(3) specifically refers to life insurance as a type of insurance subject to de novo review by a court, as well as a jury trial, where a claim has been denied in whole or in part.[6] Future legislation or case law may resolve the apparent conflict between the two statutes with regard to life insurance.

The New Salida *Opinion*

It is unclear whether § 1115(1)(b)(II) applies to an insured seeking coverage for defense and indemnity obligations from the insured's own liability insurance carrier. In *New Salida Ditch Co., Inc. v. United Fire & Cas. Ins. Co.*,[7] New Salida's §§ 1115 and 1116 claims were dismissed because, among other reasons, the court found that the claims were third-party claims based on the insurer's failure to provide coverage under a general liability policy; therefore, they were excluded by § 1115(1)(b)(II). This decision currently is on appeal to the Tenth Circuit.[8]

On appeal, the appellant New Salida referred to an affidavit from Daniel W. Patterson, who was involved in the drafting of CRS § 10-3-1115. He stated that the intent of subsection II "was to preclude claims by individuals who were assignees under *Bashor* agreements."[9] (There was no *Bashor* agreement in this case.) New Salida argued that the plain language of the statutory definition of "first-party claimant" includes any liability policyholder seeking benefits contracted for with the insurer, including the defense and indemnity obligations the insurer owes directly to its insured under a liability policy. Thus, an insured who seeks a defense and indemnity from its own general liability insurer is a first-party claimant and the district court's ruling should be overturned.[10]

Appellee United Fire, in its Response Brief, argued that the statutes apply only to first-party claims. United Fire also argued that the Colorado Supreme Court in *Farmers Group, Inc. v. Williams*[11] determined that, where the benefit derives from the insurer's duty to defend the insured against third-party actions, that relationship is characterized as a third-party claim. Because the insurer's duty to defend arises only on the filing of a suit by a third party, United Fire argued that New Salida's claim is a third-party claim and therefore not covered by the statutes.[12]

Stresscon Corp. *Order*

Before the Tenth Circuit issues its opinion, practitioners may look to an unrelated state court opinion issued April 22, 2010 by Denver District Court Judge Morris Hoffman. Examining claims similar to those asserted in New Salida, Judge Hoffman determined that the statutes apply to an insured claiming the insurer owes a benefit under a contract of insurance, including an insurer's obligation to defend and indemnify under a liability policy.[13]

Claims Under the Statutes vs. Bad Faith

The standard contained in § 1115 arguably is less onerous on the insured, and the remedies contained in § 1116 are more financially threatening to the insurer than a traditional common law bad faith claim. Claims for common law bad faith require proof of unreasonable denial or delay in payment of a claim, with the added requirement that the insurer knew or recklessly disregarded the unreasonableness of its actions.[14] Even if an insured succeeds on a bad faith claim, he or she can recover more than the original covered benefit only by proving other damages that resulted from the insurer's bad faith.[15] This typically was difficult for entities that could not allege claims for noneconomic damages suffered as a result of the insurer's bad faith.[16]

Moreover, an award of exemplary or punitive damages (often paired with a bad faith claim) against an insurance company is appropriate only if "the injury complained of is attended by circumstances of fraud, malice, or willful and wanton conduct."[17] The insured receives exemplary damages only by showing "willful and wanton conduct," which is defined as "conduct purposefully committed [that] the actor must have realized as dangerous, done heedlessly and recklessly, without regard to consequences, or of the rights and safety of others."[18] An insured may not add to a complaint a request for punitive damages until he or she can establish *prima facie* proof of a triable issue that the insurance company purposefully behaved in a dangerous, heedless, and reckless manner "without regard to consequences, or of the rights and safety of others."[19]

CRS § 10-3-1115 carves out a standard, different from common law bad faith, based only on reasonableness. The statute specifies:

> [n]otwithstanding section 10-3-1113(3), an insurer's delay or denial was unreasonable if the insurer delayed or denied authorizing payment of a covered benefit without a reasonable basis for that action.[20]

Although the insured's burden remains the same as bad faith with regard to proving that the delay or denial was unreasonable,[21] the insured's burden as a whole may be less onerous in many instances, because the insured does not have to prove the insurer knew or recklessly disregarded the unreasonableness of its actions.[22]

The remedies of § 1116 do not require any additional showing beyond the unreasonableness of the delay or denial of benefits. Unlike common law bad faith, the insured does not have to prove damages that resulted from the insurer's bad faith. The insured need only prevail on the § 1115 claim to receive twice the covered benefit.[23]

The insured does not have to prove the insurer's conduct was willful or wanton. Moreover, given the possibility of recovering attorney fees, certain insureds will be less concerned with the possibility of winning the case only to break even—that is, using most or all of the recovered insurance proceeds to pay legal expenses. If the insured proves that benefits were unreasonably delayed or denied, he or she will be awarded reasonable attorney fees.[24]

Section 1116 also states:

> The action authorized in this section is in addition to, and does not limit or affect, other actions available by statute or common law, now or in the future. Damages awarded pursuant to this section shall not be recoverable in any other action or claim.[25]

The statute may allow a successful plaintiff to recover damages for breach of contract, plus damages resulting from bad faith, punitive damages, and damages pursuant to the statutes. Future case law may clarify whether an award pursuant to the statutes for twice the covered benefit, plus attorney fees and costs, is punitive in nature and therefore duplicative of a separate award for punitive damages. An instruction regarding duplicative recovery may be necesssary for juries contemplating damages pursuant to the statutes.

Private Right of Action not Preempted by ERISA

Before the enactment of the statutes, the Colorado Insurance Code did not include a private right of action. Section 1116 declares that a first-party claimant whose claim for payment has been unreasonably delayed or denied may file an action in district court.[26]

The statutes are especially noteworthy for ERISA[27] insurers, because the remedies section states, "this section is a law regulating insurance."[28] Therefore, pursuant to 29 U.S.C. § 1144(b)(2)(A), the preemptive effects of ERISA are avoided. Insurers must note that § 1116 prohibits health or disability policies from including provisions purporting to reserve discretion to the insurer, plan, or claim administrator to interpret the terms of the policy.[29] Moreover, any policy, contract, or plan issued in Colorado must provide that a person claiming health, life, or disability benefits, whose claim has been denied and whose administrative remedies have been exhausted, is entitled to *de novo* review of the claim and a jury trial.[30] The U.S. District Court for the District of Colorado has confirmed in *McClenahan v. Metropolitan Life Ins. Co.*[31] that § 1116 is saved from preemption by ERISA.[32] The companion Tort and Insurance Law article by Shawn McDermott on page 75 provides a detailed discussion of this subject.

Insurers' Redress for Frivolous Actions

The drafters of the statutes specifically included protections for insurers by way of penalties for frivolous actions. As with common law claims for breach of contract and bad faith, if a court determines that an action under § 1116 is frivolous, the court must award attorney fees and costs to the defendant.[33]

Applicability: Relevant Case Law

At present, only a handful of slip opinions and one published opinion consider the statutes. Four of these opinions provide that the statutes do not apply retroactively where the insurer's denial occurred before August 5, 2008.[34] Three opinions hold that the statutes apply to an insurer's actions after August 5, 2008, where the claim was presented prior to August 5, 2008, but the insurer had not yet denied the claim.

In *Creekside Townhomes HOA, Inc. v. Travelers Casualty Surety Co.*,[35] the insurer filed a motion for summary judgment, asserting plaintiff's § 1116 claim was barred because the insurer did not deny the claim and the delays in payment arose before August 5, 2008. The U.S. District Court for the District of Colorado denied the motion for summary judgment based on the existence of material facts with respect to whether the insurer denied or delayed resolving the claim for benefits after the statutes' effective date.[36]

In *Morrissey v. Allstate Ins. Co.*,[37] the U.S. District Court for the District of Colorado denied summary judgment on claims under the statutes, because defendant insurer provided no evidence of whether or when it denied benefits. The plaintiff was permitted to proceed and present evidence as to the insurer's conduct after the date the statutes were enacted.38

In *Cunningham v. Standard Fire Ins. Co.*,[39] the insured's claim had not yet been

denied. The U.S. District Court for the District of Colorado determined that the statutes may apply to acts of unreasonable delay or denial by the insurer that occurred after the effective date of the statutes.[40]

These opinions raise questions regarding remedies. For example, if the insured proves the insurer's delay or denial occurring after August 5, 2008 was unreasonable, would the insured still recover twice the covered benefit even though the statutes may not apply to the insurer's delay prior to August 5, 2008? Would the insured receive all reasonable attorney fees, or only attorney fees incurred after the statutes' enactment date or after the date the insured amended the complaint to add claims under the statutes? Later opinions likely will shed light on these issues.

Conclusion

CRS §§ 10-3-1115 and -1116 expand the remedies available for first-party claimants seeking wrongfully delayed or denied insurance benefits. Insurers anticipating litigation may need to adjust litigation risk assessments because of the possibility of paying not only their own defense costs but also their insured's court costs, attorney fees, and twice the covered benefit.

Notes

1. CRS § 10-3-1115(1)(b)(I).

2. CRS § 10-3-1115(1)(b)(II).

3. CRS § 10-3-1115(5).

4. CRS § 10-3-1115(6).

5. *Id*.

6. CRS § 10-3-1116(3).

7. *New Salida Ditch Co., Inc. v. United Fire & Cas. Ins. Co.*, No. 08-cv-00391, 2009 WL 5126498 at *5 (D.Colo. Dec. 18, 2009).

8. *New Salida Ditch Co., Inc. v. United Fire & Cas. Ins. Co*, appeal docketed, No. 10-1010 (10th Cir. Jan. 19, 2010).

9. *See* Brief for Appellant at 44, *New Salida, supra* note 7. *See also* Affidavit of Daniel W. Patterson at ¶7, *New Salida, supra* note 7, available at 2010 WL 516902.

10. *See* Brief for Appellant, *supra* note 9 at 43.

11. *Farmers Group, Inc. v. Williams*, 805 P.2d 419, 421 (Colo. 1991).

12. *See* Response Brief for Appellee at 53-55, *New Salida, supra* note 7 (on file with author).

13. *See* Order, *Stresscon Corp. v. Rocky Mountain Structures, Inc.*, No. 2009-cv-3252 at 1-5 (April 22, 2010) (on file with author).

14. *Dale v. Guar. Nat'l Ins. Co.*, 948 P.2d 545, 551 (Colo. 1997).

15. *Goodson v. Am. Standard Ins. Co. of Wisconsin*, 89 P.3d 409, 417 (Colo. 2004) (insured must prove damages resulting from bad faith by a preponderance of the evidence).

16. *See Johnstown Feed & Seed, Inc. v. Continental Western Ins. Co.*, 641 F.Supp.2d 1167, 1174-75 (D.Colo. 2009) (only the corporation as named insured has standing to assert a bad faith claim; noneconomic damages arising out of claims for emotional distress inure only to individual shareholders).

17. CRS § 13-21-102(1)(a).

18. CRS § 13-21-102(1)(b).

19. CRS § 13-21-102(1.5)(a). *See also U.S. Fire Ins. Co. v. Sonitrol Mgmt. Corp.*, 192 P.3d 543, 549 (Colo.App. 2008).

20. CRS § 10-3-1115(2). CRS § 10-3-1113(3) is the codification of common law bad faith.

21. *See State Farm Mut. Auto. Ins. Co. v. Fisher*, No. 08-cv-01687, 2009 WL 2766763 at *7 (D.Colo. Aug. 27, 2009). The insurer filed a declaratory judgment action regarding coverage. The insured filed counterclaims pursuant to the statutes. The court applied the same reasonableness standard used in common law bad faith cases. The court relied on *Brennan v. Farmers Alliance Mut. Ins. Co.*, 961 P.2d 550, 557 (Colo.App. 1998) and awarded summary judgment in favor of the insurer, because the coverage decision was complex, fact-intensive, and "fairly debatable"; thus, the insurer was reasonable in seeking a judicial determination of coverage.

22. This statement is based on a plain reading of the statutes; however, the precise interpretation of the statutes is uncertain, given the dearth of case law to date.

23. CRS § 10-3-1116(1).

24. *Id*. It is unclear whether courts will award attorney fees and how the amount of attorney fees will be calculated in cases where only some of the insurer's unreasonable actions occurred after August 5, 2008.

25. CRS § 10-3-1116(4).

26. *Id*.

27. The federal Employee Retirement Income Security Act (ERISA) governs employee benefits programs, such as disability, health, and life insurance provided by an employer.

28. CRS § 10-3-1116(7).

29. CRS § 10-3-1116(2).

30. CRS § 10-3-1116(3).

31. *McClenahan v. Metro. Life Ins. Co.*, 621 F.Supp.2d 1135, 1144 (D.Colo. 2009).

32. *Id. See also Kohut v. Hartford Life and Acc. Ins. Co.*, No. 08-cv-00669, 2008 WL 5246163 at *9 (D.Colo. Dec. 16, 2008) (CRS § 10-3-1116 is not preempted by ERISA).

33. CRS § 10-3-1116(5).

34. *New Salida, supra* note 7 at *4 (CRS §§ 10-3-1115 and -1116 do not apply retroactively; insurer's denial occurred prior to effective date of the statutes and therefore claims under both statutes dismissed); *McClenahan, supra* note 31 at 1143 (claim pursuant to CRS § 10-3-1116 not applicable because insurer's denial occurred before enactment of statute and statute does not apply retroactively); *James River Ins. Co. v. Rapid Funding, LLC*, No. 07-cv-01146, 2009 WL 524994 at *9 (D.Colo. March 2, 2009) (insurer denied claim and filed lawsuit prior to enactment of CRS §§ 10-3-1115 and -1116, insurer's continuing conduct after August 6, 2008 does not form the basis for a new a new bad faith claim or applicability of the statutes); *Kohut, supra* note 32 at *10 (denial of benefits occurred before August 5, 2008; court determined CRS § 10-3-1116 not applicable to case because statute does not apply retroactively).

35. *Creekside Townhomes HOA, Inc. v. Travelers Casualty Surety Co.*, No. 08-cv-02240, 2010 WL 1348480 at *4 (D.Colo. March 31, 2010).

36. *Id.*

37. *Morrissey v. Allstate Ins. Co.*, No. 08-cv-02174, 2009 WL 1384099 at *1 (D.Colo. May 14, 2009).

38. *Id.*

39. *Cunningham v. Standard Fire Ins. Co.*, No. 07-cv-02538, 2008 WL 4861928 at *1 (D.Colo. Nov. 10, 2008) (unpublished).

40. *Id.*