When Must an Insurer Pay a Claim?

May 2007

After a loss, a commercial policyholder needs to get repairs completed and business back up and running at full speed as quickly as possible. Frequently, the proceeds of the property insurance policy are necessary to accomplish this very important goal. Not all policyholders have the ability to finance repairs themselves while they wait for the adjustment process to be completed and the insurance company to pay the loss.

by Jay M. Levin
Reed Smith

Many insurers recognize this and will frequently advance a portion of the loss payment at an early date to speed repairs and help the insured recover from the casualty. This is particularly true in larger losses where there is less risk that an advance will exceed the ultimate amount of loss.

Some insurers, however, are much less willing to make advance payments, even where the insured needs the money to begin or complete repairs. In those situations, the insured business may end up suffering additional and unnecessary losses. These situations invariably lead to the question of when*must* an insurer pay a loss? The answer is not as clear-cut as one might think.

Proof of Loss

The date a loss becomes payable is generally determined by the policy or state statute or regulation. As with any insurance coverage question, the best place to start is the policy language. Typical commercial property policy language is as follows:

We will pay for a covered loss within thirty days after we receive the sworn proof of loss if:

1. You have complied with all of the terms of this policy; and
2. We have reached agreement with you on the amount of loss; or
3. an appraisal award has been made.

Under this and similar provisions, three things must occur before an insurer is obligated to pay: (1) a proof of loss must be submitted to the insurer; (2) ascertainment of the loss or damage

must be made by agreement between the insured and the insurance company or by appraisal or judgment; and (3) 30 days (60 or 90 days under some policy forms) must elapse from the date the proof of loss is submitted and the loss is ascertained. Usually all three are necessary.

While "proofs of loss" have been used in property insurance claims for over 100 years, different policies have different requirements for what must be contained in a proof of loss. Most require that the insured provide a sworn proof of loss stating the time and origin of loss, identifying anyone with an interest in the insurance proceeds, and the amount of loss. Insurers will frequently reject proofs of loss if they are for other than an agreed amount of loss or if some of the required information is missing. However, courts generally require only substantial, rather than strict, compliance with the provisions for proofs of loss.

The main impediment in obtaining money from the insurer is usually disagreement over the amount of loss. Most commercial property policies make no provision whatsoever for advance payments. Even those policies that do, almost invariably state that the insurer has complete discretion as to whether it will make an advance payment. However, most property insurers will timely investigate a loss and begin the adjustment process by compiling estimates of the cost to repair or replace the property. In that situation, the policyholder has a strong argument that, at least as to the amount of the loss calculated by the insurer, there is agreement between the policyholder and the insurer.

The policyholder should argue to the insurer that as long as the policyholder submits a satisfactory proof of loss for a partial payment, the insurer's time within which payment must be made has been triggered. As a practical matter, therefore, it is very important for the insured and its adjustment team to make sure that the insurer is moving quickly to investigate and calculate the amount of loss and that copies of the insurer's estimates are promptly obtained. That way, even if the insurer is initially reluctant to make an advance payment, the insured has a strong argument that the insurer has agreed at least to the amount of loss it has calculated, which should be paid.

On the other hand, some courts have rejected this concept. *See, e.g.,Florists' Mut. Ins. Co. v. Tatterson*, 802 F. Supp. 1426, 1437 (E.D. Va. 1992). The*Tatterson* court explained that there is nothing in the policy which required the insurer to make any advance whatsoever.

Unfair Trade Practice Laws

Many states attempt to prevent unreasonable delays by insurers in the payment of claims with unfair trade practice laws. Conduct constituting unfair claims settlement practices under these laws include:

- Failing to act *reasonably promptly* upon communications with respect to claims.
- Failing to adopt and implement *reasonable* standards for the *prompt* investigation and processing of claims.
- Failing to affirm or deny coverage of claims *within a reasonable time after proof of loss requirements have been completed and submitted*.
- Not attempting in good faith to effectuate *prompt*, fair, and equitable settlements of claims in which liability has become *reasonably* clear.
- *Delaying* the investigation or payment of claims by requiring the insured to submit a preliminary claim report, and then requiring the subsequent submission of a formal proof of loss, both of which contain substantially the same information.
- Failing to *promptly* settle claims where liability has become *reasonably* clear under one portion of the insurance policy to influence settlements under other portions of the insurance policy.

The common issue throughout the various state statutes is whether any delay in claims handling or payment is reasonable. Only where delay is unreasonable will an unfair claims settlement practice be found. Of course, many of these statutes do not provide for a private cause of action. Those that do not offer no help to the policyholder.

Duty of Good Faith and Fair Dealing

An insurer's delay in payment of a loss is a common basis for bad faith claims. Reasonableness of the delay is again the key element in determining if there is a valid cause of action. In most jurisdictions which recognize first-party bad faith, before an insurer can be found to have acted in bad faith due to delay in payment of policy benefits, it must be shown that the insurer acted unreasonably or without proper cause. What is reasonable must be evaluated as of the time of the insurer's decisions and actions. Damages available for bad faith delays vary from state to state and often include an award of punitive damages, attorney fees, penalty interest, prejudgment interest, and/or consequential damages.

Delays in the payment of a claim might also lead to the award of consequential damages. For example, business interruption coverage is typically provided for a defined period of time, which is considered to be the amount of time necessary to repair or replace the damaged property. In circumstances where an insurer unreasonably delays paying a loss, some courts

may enlarge the period of restoration by the time it took for the insurer to begin paying the claim.

Conclusion

Most property insurance claims are paid in a timely fashion and in a manner which reduces the loss and inconvenience to the insured. However, where there is unreasonable delay on the part of the insurer, remedies may be available to compensate policyholders for that delay. The availability of those remedies also acts as a deterrent to insurers which ignore their responsibility to pay losses in a timely fashion.