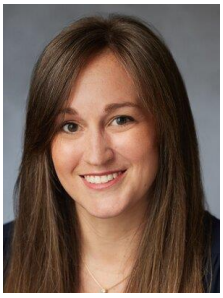
Ore. Insurance Ruling Opens Door To Extracontractual Claims

By **Tessan Wess** (February 9, 2024, 5:54 PM EST)



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For the first time in Oregon, claimants have a legal basis to pursue first-party negligence claims for emotional distress damages against insurers.

The Oregon Supreme Court issued an opinion in Moody v. Oregon Community Credit Union on Dec. 29, 2023, expanding an insurer's potential liability when adjusting life insurance policies in Oregon. This could have far-reaching implications for the recovery of extracontractual damages.

This article offers a brief history of emotional distress damages in Oregon in the context of an insurance claim and considers Moody's impact on the legal landscape for such claims, with some practical considerations for insurers and contracting parties in Oregon.

History of Emotional Distress Damages in Oregon

In Oregon, there is no legally protected interest in being free from emotional distress. According to the Moody court:

In contrast to physical harms, emotional harms occur frequently. … Emotional distress, like economic loss, ripples throughout society as a foreseeable result of negligent conduct. Without some limiting principle in addition to foreseeability, permitting recovery for emotional injuries would create indeterminate and potentially unlimited liability.[1]

Claims for emotional distress damages are cognizable in the following three circumstances: (1) when the defendant also physically injures the plaintiff; (2) when the defendant intentionally causes the emotional distress; or (3) when the defendant "negligently causes foreseeable, serious emotional distress and also infringes some other legally protected interest," the court added.[2]

As to the third circumstance, there have been few other instances in which Oregon courts have acknowledged some other legally protected interest.[3]

In the context of insurance policies, the generally accepted rule in Oregon is that emotional distress caused by pecuniary loss resulting from breach of contract is not recoverable. This principle was subject to a challenge in 1978 in Farris v. U.S. Fidelity & Guarantee Co., known as "Farris II," and the Oregon Supreme Court expressly affirmed this rule.[4]

In Farris II, the plaintiffs were partners in a sandwich shop who alleged that they had been sued by a business competitor for unfair business practices; that they had tendered the defense to a third-party insurer; and that the third-party insurer denied the tender in bad faith, causing them emotional distress.

The Oregon Supreme Court was tasked with determining "whether damages for emotional distress may be awarded in a case of this kind."[5] To answer this question, the court looked to Oregon statutes and common law, and focused its analysis on ORS 746.230.

ORS 746.230 provides a standard of care for insurers in Oregon and enumerates unfair claim settlement practices.

For example, ORS 746.230 prohibits insurers from "[f]ailing to acknowledge and act promptly upon communications relating to claims,"[6] "[f]ailing to affirm … coverage of claims within a reasonable time,"[7] and "[c]ompelling claimants to initiate litigation to recover amounts due."[8]

Looking to the text of ORS 746.230, the court in Ferris II stated:

There is nothing to indicate that the legislature intended, when it prohibited certain claims settlement practices in ORS 746.230, that actions for breach of insurance contracts would be transformed, in all of the covered instances, into tort actions with a resulting change in the measure of damages. The statute expresses no public policy which would promote damages for emotional distress.[9]

And looking to common law, the court noted that there was no basis to support a tort claim based on the bad faith breach of a contractual obligation. The court expressly asserted that such claims in Oregon "could only have been a breach a contract, and in cases of breach, the law is clear that [there is] no recovery for mental distress."[10]

With the legal principles articulated in Farris II, the well-established law in Oregon is that recovery for breach of an insurance contract does not include recovery for emotional distress damages.

The practical impact of that law has limited the type of claims that can be asserted against and the extent of damages recoverable from insurance providers and contracting parties in Oregon. However, with the new opinion in Moody, the legal landscape in Oregon has effectively changed.

Change of Law in Moody

This landmark decision arises from a life insurance claim for $3,000. The claimant-widow sought life insurance proceeds following the accidental death of her spouse, who was shot and killed while camping.

The insurer denied the claim for life insurance benefits on the grounds that the deceased spouse had cannabis in their system, pointing to a policy exclusion for death "caused by or resulting from [the decedent] being under the influence of any narcotic or other controlled substance."

The claimant sued for breach of contract and negligence, as the gunshot — and not cannabis — was the cause of death. The claimant sought noneconomic damages relating to the wrongful denial of the claim, alleging that, as a result of the insurer's negligence, she suffered "the non-economic loss of increased emotional distress and anxiety caused by having fewer financial resources to navigate the loss."

The negligence claim was dismissed at the trial court level, based on Farris II. However, the Oregon Court of Appeals reversed the trial court, prompting review by the Oregon Supreme Court.

By a 4-to-3 vote, the Oregon Supreme Court affirmed the appellate decision, exposing

insurers, for the first time in Oregon, to extracontractual tort liability for a violation of Oregon's unfair claim practices.

To support its holding in the context of Farris II — and without overruling Farris II — the court distinguished the issues presented in each case:

In Farris II, the plaintiffs' complaint did not allege in either count, that the defendant owed them an obligation other than that specified in the contract between them. In particular, the plaintiffs' complaint did not allege that the defendant's actions were negligent.[11]

With that distinction, the Oregon Supreme Court concluded that Farris II did not bar its consideration of the viability of the claimant-widow's alleged common law negligence claim. In its analysis, the court considered three factors it said had been important to its decisions previously:

- Whether an Oregon statute indicates the existence of the alleged legally protected interest;
- Whether permitting recovery of emotional distress damages is consistent with recovery of emotional distress damages in other common law actions and would not place an undue burden on defendants; and
- Whether the plaintiff's interest is of significant importance as a matter of public policy.

As to the first factor — whether an Oregon statute indicates the existence of the alleged legally protected interest — the court referred to ORS 746.230 and concluded that ORS 746.230(1) indicates the existence of a legally protected interest:

We find that the statute provides explicit notice to insurers of the conduct that is required, and in requiring insurers to conduct reasonable investigations and to settle claims when liability becomes reasonably clear, does so in terms that are consistent with the standard of care applicable in common law negligence cases.[12]

As to the second factor — whether permitting recovery of emotional distress damages would place an undue burden on defendants — the court acknowledged that the Legislature's decision not to create a statutory private right of action could expose defendants to new and unfairly burdensome liability.

The court quickly disposed of that concern, however, noting that the parties in Moody "were in a contractual relationship" with one another that "entailed a 'mutual expectation of service and reliance.'"[13]

That said, the contractual relationship between the parties was not solely determinative. The court also looked to "objective indicators of possible serious emotional injury" and within the context of life insurance benefits, concluded that there were objective indicators of such injury.[14]

Finally, the court analyzed whether the plaintiff's alleged interest is of significant importance.

On this point, the court focused heavily on the specific insurance benefits at issue, noting

that life insurance proceeds enable surviving beneficiaries to obtain basic needs such as food and shelter, such that beneficiaries are not dependent on society for those needs.

The court also leaned on Oregon statutes governing the insurance industry, noting that such statutes indicate a public policy choice to protect against unfair processing and payment of insurance claims: "When a surviving spouse incurs serious emotional distress as a result of the violation of those statutes, the harm and the statutory purpose are of sufficient importance to merit protection."[15]

The court went on to say:

Considering all of those factors, and not relying on any one of them alone, we conclude that the insurance claim practices that ORS 746.230 requires and the emotional harm that foreseeably may occur if that statute is violated are sufficiently weighty to merit imposition of liability for common-law negligence and recovery of emotional distress damages.[16]

With this legal precedent, Oregon is now, for the first time, a jurisdiction that permits recovery for emotional distress damages against first-party insurers, joining states like Washington, California, Arizona, Idaho and many others, that provide a statutory right of action or other common law precedent supporting such claims.[17]

Expectations and Application to Future Litigation

The full extent of the decision's applicability has yet to be further yielded, through legislation or further litigation. It is not clear if this decision extends beyond first-party life insurance claims to other first-party claims involving other types of insurance policies or third-party claims. With the door opened by the Oregon Supreme Court, we can anticipate claims:

- In the first-party context involving allegations of negligent handling of an insurance claim, and
- In the third-party context involving negligent handling of tenders of defense and/or indemnification

Notably, in its holding, the court expressly cautioned "that our conclusion here does not make every contracting party liable for negligent conduct that causes purely psychological damage, nor does it make every statutory violation the basis for a common-law negligence claim for emotional distress damages."[18]

For insurers and other contracting parties in Oregon, the court embedded the following guidance within its analysis:

[C]ontracts may, at times, provide a means for a defendant to control the extent of its liability. That is, a contract between a service provider and recipient potentially may alter or eliminate tort liability or remedies … parties may limit tort remedies by defining their obligations in such a way that the common law standard of care has been supplanted, or, in some circumstances, by contractually limiting or specifying available remedies.[19]

With the door open to extracontractual claims and no clearly defined limit to its application, this case prompts a significant change in first-party insurance litigation in Oregon.

In the short time since the Moody opinion, the Oregon docket has seen a rise in negligence claims seeking emotional distress damages in uninsured and underinsured motorist coverage lawsuits, property damage insurance claims and against insurance-appointed defense counsel involving allegations of professional negligence.

It is anticipated that the limits of this law and boundaries of its application will be tested through aggressive litigation.

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[1] Moody v. Oregon Community Credit Union, quoting Philibert v. Kluser, 360 Or 698, 703-04, 385 P3d 1038 (2016) (some citations).

[2] Moody, 371 Or at 784.

[3] See, e.g., Hinish v. Meier & Frank Co., 166 Or 482, 506, 113 P2d 438 (1941) (allowing claim for emotional distress when plaintiff's name was signed without his consent on a telegram to governor); Nearing v. Weaver, 295 Or 702, 708, 670 P2d 137 (1983) (right to have officers comply with statute requiring arrest to protect victims of domestic violence); McEvoy v. Helikson, 277 Or 781, 787-89, 562 P2d 540 (1977) (right to have lawyer comply with order to protect father's interest in child's custody); Hovis v. City of Burns, 243 Or 607, 613, 415 P2d 29 (1966) (right to have the remains of a deceased spouse remain undisturbed).

[4] Farris v. U.S. Fid. & Guar. Co., 284 Or 453, 587 P2d 1015 (1978) ("Farris II").

[5] Id. at 455-56.

[6] ORS 746.230(1)(b).

[7] ORS 746.230(1)(e).

[8] ORS 746.230(1)(g).

[9] Id. at 457-58.

[10] Id. at 464-65.

[11] Moody, 371 Or at 796.

[12] Moody, 371 Or at 799.

[13] Id. at 800-03.

[14] Id. at 803-04.

[15] Id. at 804.

[16] Id. at 805.

[17] See, e.g., Nassen v. National States Ins. Co., 494 NW2d 231 (Iowa 1992) (insurer liable in tort for emotional distress damages for bad faith denial of claim); Curry v. Fireman's Fund Ins. Co., 784 SW2d 176 (Kentucky 1989) (permitting recovery in tort for consequential and punitive damages for bad faith breach of insurance contract); White v. Unigard Mut. Ins. Co., 112 Idaho 94, 730 P2d 1014 (1986) (insurer liable in tort for bad faith denial of claim); Noble v. Nat'l Am. Life Ins. Co., 128 Ariz 188, 624 P2d 866 (1981) (permitting emotional distress damages in tort action arising out of insurer's willful refusal to pay a valid claim); Gruenberg v. Aetna Ins. Co., 9 Cal 3d 566, 510 P2d 1032 (1973) (insurer liable in tort for emotional distress damages for violation of implied covenant of good faith and fair dealing).

[18] Moody, 371 Or at 805-06.

[19] Id. at 803.