

Defending the Algorithm™: Strategic Approaches to Defending Claims of AI-Related Bad Faith Insurance Practices

A Bayesian Approach: $P(A|B)$ = The (P) Probability of (A) New Bad Faith Litigation Strategies by Plaintiff's Lawyers (I) GIVEN (B) The Growing Use of AI by Insurers

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$P(A|B) = (P)$ of “AI” As An Issue in Bad Faith Litigation is High

- Bayes Theorem is one of the two major theories on the law of probabilities (Other one is “frequentist”);
- The probability of the (A event) Plaintiff’s bar developing new theories to claim bad faith on use of AI by Insurers is high;
- The probability of another (A event) Plaintiff’s bar developing new “AI-Based” theories to implicate insurance regs. like the Unfair Insurance Practices Act is high;
- The (B prior events which have already occurred) is that Insurers now use AI in all cycles and the AAJ is always on the hunt for new bad faith claims;
- It is the high likely probability that an (A event) will occur given that the (B events) already exist or have occurred;

Claude* Predicts Increasing Reliance By Plaintiff's On AI - Based Bad Faith Strategy

- **“Current Trends** in use of AI by insurers at the front end (Underwriting) and the back end (Claims Handling) create new vectors for bad faith claims because;
- **AI systems operate as “black boxes”** with opaque decision making processes that are tough to explain;
- **Regulatory Momentum** as States and Insurance Departments seek to regulate use of AI in insurance;
- **Precedent** is developing even outside the “Bad Faith” arena which could impact bad faith claims;
- **Practical Challenge:** prove that AI makes reasonable decisions when even its creators don't understand it.”
- * **Claude Sonnet 4 Edition by Anthropic**

Regulatory: Pa. Insurance Department Adopts Model Bulletin [54 Pa. B 1910]

- Notice 2024-04 (April 2024) – All Insurer AI must comply with ALL Pa. insurance laws and regs:
 - Including Unfair Insurance Practices Act; Unfair Trade Practices Act and laws on Unfair Discrimination;
 - All insurers must develop an “AIS Program” governing their use of AI Systems – including in risk and claims;
 - AI System must be designed to mitigate the risk of adverse consumer outcomes...
 - Insurer must **BE PROACTIVE** and Maintain records of design, development, use... of predictive models... (their own and those of third parties)

Pa. Unfair Insurance Practices Act:

Think About Use of AI In Both Underwriting and Claims Handling - Fertile Ground Here for Plaintiffs

- Prohibits Unfair Practices; Requires:
- Prompt and reasonable investigation and response to claims;
- Fair and prompt settlement;
- Written ROR and Denial letters with details;
- Timeframes for claims handling;
- Be accountable to Insurance Department;
- Uphold consumer rights;
- No Offering of lowball settlements;
- No unfair settlement acts or practices.

Insurer and TPA Claims Regarding Their AI Systems: Think About Opposite Day In A Lawsuit

■ Claims Management Process: PR

- AI also streamlines the claims' management process through intelligent workflows. **These systems can automatically route claims to the right department, prioritize urgent cases, and even settle simple claims without human intervention.** For example, some insurers are now using AI to process simple property damage claims in minutes, reducing turnaround time and improving customer satisfaction.
- “TPA’s” AI-based loss assessment allows for a **60-second claim processing**, significantly boosting customer satisfaction and reducing operational costs by up to 50%.

■ Claims Decision-Making: PR

- Predictive analytics powered by machine learning algorithms **analyze historical data to determine claim severity, estimate repair costs and detect fraud.** This data driven approach allows insurers to make more accurate and consistent decisions and fairer outcomes for policyholders and reduced losses for the insurer.
- “Insurer” uses predictive analytics to enhance decision-making processes, achieving an improvement in the accuracy of risk assessments and premium pricing.

“Claimable” Website and App

- **Appeal Your Denied Healthcare claims with AI**
<https://www.getclaimable.com/> ;
- **We believe that technology should have positive impacts on humanity. Far too often patients are left to navigate this complex process alone after a denial. The AI behind Claimable amplifies your voice, combining it with cutting-edge science and policy insights to help protect your rights.**
- **Warris Bokhari, MD**
Co-Founder & CEO

Estate of Lokken v. UnitedHealth Group (UHC): UHC Is A Medicare Advantage Organization

- USDC, D. Minn 766 F. Supp. 3d. 835 (Class Action)
- UHC Motion to Dismiss Granted in part, denied in part; **PLEADINGS:**
- Plaintiffs claim that rather than “help people live healthier lives...” – UHC uses AI model **nHPredict** to determine **post acute care** requirements and uses them to make adverse coverage determinations
 - Generally resulting in denials
- UHC admits that their mission is to “help people live healthier lives” but otherwise generally denies.

Lokken Pleadings Cont.

- Plaintiffs argue that AI used “rigid criteria” and that UHC employees were required to follow them under threat of termination;
- Plaintiffs argue that UHC knew of inaccuracies in the AI model as over 80% to 90% of AI denials are reversed on appeal;
- UHC denies any use of the nH Predict model;
- **nH Predict** was developed by defendant **NaviHealth** – which was acquired by UHC Optum Division in 2020.

UHC's 12(b)(6) Motion to Dismiss

- Lokken 7 causes of action based on AI use:
 - Breach of contract;
 - Breach of implied covenant of good faith/fair dealing;
 - Unjust enrichment;
 - Insurance bad faith;
 - Negligence per se;
 - Unfair and deceptive insurance practices;
 - Unfair competition and consumer protection.
- UHC Moves on Failure to Exhaust Admin Remedies and Federal Preemption by Medicare Act (Jurisdiction)

Lokken Opinion and Order on MTD

- The Court waives the “failure to exhaust” argument because the notice and appeal process by UHC created a futile scenario for claimants;
- All claims are preempted/dismissed **except breach of contract and implied covenant of good faith...**
 - Because those claims “do not aim to regulate the same subject matter as the federal standards...”
 - And in other words, the court need only review insurance documents to resolve those claims.
- UHC filed an Answer to the Amended Complaint and presumably discovery now begins.

Court's Bad Faith Dismissal Rationale

- Breach of contract and implied covenant claims only require Court review of contract documents;
 - Because UHC said in the policy docs that claims would be determined by clinical services staff and physicians (NOT AI) – ON THE OTHER HAND;
- Bad Faith etc. requires the Court to evaluate motive behind denial and to examine whether the denial of coverage was reasonable
 - **And whether use of nH Predict to make that denial was reasonable;**
- Such an analysis would necessarily be seeking to regulate the same subject matter as the Medicare Act – therefore preemption.

You Can See Where This Is Going

- Plaintiffs still can make a claim for breach of contract (although it likely limits the damages claims);
- Lokken can argue for Bad Faith type discovery under Breach of Implied Covenant...claims.
- Discovery could be massive and document intense;
- Perhaps this case was the wrong vehicle to test drive the AI claims denial theory due to potential preemption;
- BUT – a finding of breach would be rather important if it is found to contradict policy language that is likely found in many such policies (**who or what is making the claim decision?**);
- Those ramifications could spill over into other types of policies

Breach of Implied Covenant of Good Faith and Fair Dealing: 1st Party Property Claim Coverage Question

- Did Insured Landlord (Commercial Multi-Tenant Bldg.) use “best efforts” to turn off water during cold months where water **in vacated unit** was not turned off – and caused bursting pipes with damage to multiple units;
- Case in state court was bifurcated (Contract/bad faith);
- Jury Was to decide yes or no as to breach of the contract policy on “Best Efforts” – Bad Faith was Non-Jury later;
- Plaintiff pursued a breach of the duty of good faith and fair dealing to try to introduce bad faith (Phase 2) evidence in phase one jury trial on breach – to poison the jury – they said it was **2 kinds of contract recovery claim**.

There was a human being claims adjuster

- There was SIU involvement – human beings;
- What if insurer SIU had used AI to decide the “best efforts” question and deny coverage;
- The P of (A) insured having used best efforts when (B) AI algorithm uses LLM training to determine that in 80% of all commercial property freezing pipe claims that the landlord was at fault for not enforcing terms of leases with departing tenants.*
 - Lease required tenant to turn off the water upon vacating premises and did not do so.

Discovery Issues

- Plaintiff will want to discover who made the claims decision (particularly under the “good faith and fair dealing claim);
- If answer is “Property Claim Decider AI” (in whole or in part) – then plaintiff will ask for the algorithm;
- How does Insurer **Defend the Algorithm**TM against claims of hallucination, bias, poor training, biased training...
- Who in the company will be the designated corporate representative to explain the workings of PCDI?
- Plaintiff will claim that Best Efforts is a subjective test to be made by humans

AND AI AGREES: Claude on Best Efforts

■ The human judgment factor:

- Determining best efforts often requires understanding business relationships, industry customs, and the practical realities of implementation that may not be fully captured in documents. Courts consider factors like the party's expertise, available resources, and the specific challenges they faced - judgments that require human insight into business realities.
- AI is better viewed as a sophisticated research and analysis tool rather than a decision-maker in complex legal determinations like best efforts compliance.

Duty of Good Faith and Fair Dealing

- Plaintiffs argue that it is a second separate way to bring a breach of contract claim;
- They are vague as to whether it brings a damages claim separate and apart from the contract damages (we say that it DOES NOT) – Back Door Bad Faith;
- **BUT – they use it to seek discovery** of claims handling practices, underwriting files, claims manuals and other indicia of what would normally be seen as bad faith evidence – they can likely discover AI use

Suggested Jury Instruction By Plaintiff – End Around to Get Bad Faith Conduct Evidence Before the Jury

- As I stated previously, Plaintiff Insured also asserts claims for breach of contract based on the implied duty of good faith and fair dealing. Under Pennsylvania law, the contractual obligation to indemnify an insured under an insurance policy is separate and distinct from the contractual obligation of an insurer to act in good faith toward, and to deal fairly with, its insured. Therefore, regardless whether you find that Insurer violated its contractual obligation to indemnify Plaintiff Insured for losses arising out of damage to the building, you still must consider whether Insurer separately breached its duty of good faith and fair dealing to Insured with respect to Insured's claim under the Insurer's policy.

Pa. Has Bifurcated the Trials

- Phase 1 is meant to be breach claim to a jury;
- Phase 2 is meant to be bad faith to a Judge
- But the **alternate contract claim for “good faith”** implicates reasonableness of conduct evidence and motive like:
- ‘... evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.’

So IF We Add AI into that mix — Is AI REASONABLE?

“Good Faith” contract claim gives the plaintiff an opportunity to seek discovery of and to try to put into trial before the jury - the alleged evidence of claims decisions by the Insurer’s ‘bot; insurer conduct and motive; reasonableness or lack thereof etc.

- This is bad faith evidence and should not go to the jury in Pa. State Court trial;
- Use of AI to determine coverage, or scope of coverage could mightily complicate a breach of contract case to a jury;
- Who made the decision? Is AI reasonable? Did a human being oversee or make final decision? How much weight did said human being give to the ‘bot?

UTPCPL – Another Back Door to Bad Faith

- **UTPCPL** – not meant to govern insurance claims handling BUT;
 - Can govern sales practices, reps to potential policy purchasers, statements by agents;
 - “Representing that goods or services are of a particular standard, quality or grade, or that goods are of a particular style or model, if they are of another”;
 - Therefore UTPCPL can relate to the scope of coverage for example in specialty policies, health care policies, specialty life insurance or cancer insurance policies;
 - What if AI program determines the scope of coverage for particular losses? That’s Lokken. That can result in misrepresentation claim against insurer if the decision seems to run contrary to the sales pitch;
 - Can create exemplary damage claim (UTPCPL Multiplier, costs and legal fees)

Real Case: Plaintiff v. Life Insurance Co.

- Claims for Breach of Cancer Insurance Policy plus:
 - Negligent Misrepresentation (including claims against Agent for sales claims about scope of coverage);
 - Fraudulent Misrepresentation;
 - Violation of Unfair Trade Practices and Consumer Protection Law (UTPCPL);
 - Relating to marketing materials, commercials and reps about the policy;
 - Bad Faith for all of the above;
 - Breach of Fiduciary Duty;
 - Negligent Supervision of Agent

The Claims Process

- It was a complicated claims handling scenario as no less than 8 different “Customer Service” reps handled various aspect of several years of claims being submitted by the Plaintiff;
- Case was bifurcated and we knew we would lose contract case – we did;
- We won the bad faith trial however before a Judge*;
- The Court found grounds to let Plaintiff introduce into evidence a lot of the conduct, claims handling confusion and motive evidence that should have been irrelevant in a contract case – and Court wrongly held that she needed to hear it in any event to later decide bad faith;
- But the prejudice is clear on the Contract claims.
 - * Superior and Supreme Courts took Bad Faith verdict away.

Those Claims Could Have Been Handled By A 'bot

■ Positives and negatives;

- There were numerous complicated calculations about benefit entitlement, timing and amounts - 'bot may have handled the math problems better (to the insured advantage);
- The policy was a supplemental benefits type policy that paid money to the insured if she had cancer – with many limitations and exclusions. 'bot may not have gotten confused like the multiple claims people did;
- Policy premiums schedule was variable and complicated and the company (humans) lost track of what and when she had paid, as coverage determinations were being made. Claims were mistakenly paid or not paid;
- AI might have done better – BUT – defense strategy, discovery and litigation costs would be complicated and expensive;
- And the company would need to have advanced rules in place for AI.

Other claims by Plaintiffs – Property Damage Insurance Claims

- Property Damage claims current strategies;
 - Bring No Claim, or only partial claim for breach of contract because some claims were paid;
 - Claim for Bad Faith due to too little too late theory;
 - Due to Dispute over ACV and RCV per restoration or lack thereof;
 - Claims for bad faith claims handling (including breach of duty of good faith and fair dealing) for:
 - Delaying restoration; refusing to inspect; failure to inform insured of coverage provisions; violating the Unfair Insurance Practices Act; punitive damages; legal fees
 - Insert an AI Component to make the ACV/RCV decision?

Claude: “AI can significantly assist insurers in determining eligibility for ACV versus RCV coverage in property damage losses.”

- **AI Applications in Coverage Eligibility Determination**
- **Policy Analysis and Interpretation** AI-powered policy analysis tools are designed specifically for insurance agencies, brokers, and underwriters. They understand the nuances of coverage terms, exclusions, and compliance regulations, ensuring highly accurate and instant comparisons and determinations.
- AI can automatically read, parse, and analyze policy documents to determine coverage eligibility. These systems can extract policy and claims data from any format, validate it against established rules, and make determinations about coverage applicability.
- **Automated Coverage Assessment** AI can analyze large amounts of data from external events and customer-supplied information to help price policies appropriately and determine coverage eligibility. This includes assessing risk factors and policy terms to make informed coverage decisions.
- Advanced AI systems can make real-time decisions regarding underwriting and pricing, enabling proactive determinations about coverage eligibility based on the buyer's risk profile and coverage needs.

The Province of AI in Claims Handling: All Can Be Implicated in Bad Faith Claims

- Calculation of ACV or Replacement Cost;
- Typical time for property restoration;
- Calculation of Business Income;
- Calculation of complicated claims payments in specialty policies;
- Underwriting standards can be discoverable – Is AI involved?;
- Typical value of anything – based on LLM databases;
- Problems:
 - Misapplication of standards for fraud
 - Bias – hallucinations – discrimination
 - Typical values can be attacked as arbitrary and capricious – too rigid
 - Reasonableness? How to prove? Who explains the workings of the black box algorithm to a jury?
 - Do we need to have experts on AI?
 - Litigation Costs will be larger

AI Fake Claims Submissions



Fake Property Claims by AI



Defending the Algorithm™

- This presentation is part of a series of materials authored by Pittsburgh Business, IP and AI Litigation lawyer Henry M. Sneath of the law firm Houston Harbaugh, P.C. Feel free to contact him at sneathhm@hh-law.com or 412-288-4013. His bio can be found at <https://hh-law.com/professionals/henry-sneath-houston-harbaugh-business-litigation-ip/>

Questions?

Thank You!

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