ARTIFICIAL INTELLIGENCE IN THE INSURANCE INDUSTRY AND BAD FAITH RISK

MARY BORJA[*], EDWARD J. CURRIE, JR.[**] & LORELIE MASTERS[***]

[*] Mary E. Borja, Wiley Rein LLP. She thanks Megan Hovious of Wiley Rein LLP for her assistance in preparing the article.

[**] Edward J. "Ned" Currie, retired from Currie Johnson & Myers, P.A.; Founding Regent, American College of Coverage Counsel; past President and namesake of the Edward Currie Founders Award for lifetime achievement in the field of insurance law.

[***] Lorelie Masters, Hunton Andrews Kurth LLP; co-founder and second President of the American College of Coverage Counsel.

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I. INTRODUCTION

As with nearly every other sector of the American economy, interest in AI has exploded within the insurance industry in recent years. Today, 80% of all insurers have implemented or plan to add AI components to their claims infrastructure within a year.[1] Similarly, a new study reports that 77% of companies are integrating AI into their operations.[2]

The shift towards AI is not just about automation; it is also about harnessing the power of advanced algorithms to analyze complex data sets, identify patterns, and predict outcomes with a level of precision that surpasses human capabilities. In particular, insurers hope that AI will help them to streamline the claims process and make it more efficient by reducing the time and resources required to handle claims while at the same time enhancing the accuracy of assessments.

Moreover, AI's ability to process vast amounts of data quickly and efficiently enables insurers to offer more personalized services to their customers. For instance, AI can help identify individual customer needs and preferences, allowing insurers to tailor their products and services accordingly. This personalization can lead to increased customer satisfaction and loyalty, as policyholders feel that their specific needs are being addressed more accurately.

The integration of AI in the insurance industry also presents opportunities for innovation. Insurers can develop new products and services that leverage AI's capabilities, such as real-time risk assessments and dynamic pricing models. These innovations can enhance the overall customer experience and provide insurers with a competitive edge in a rapidly evolving market.

In this article, we will first review the history of artificial intelligence. Next, we will consider the specific applications of AI in insurance underwriting and claims handling. Having set the stage, we will proceed to examine the types of conduct that will likely generate AI/bad faith claims. Finally, we will address how the very nature of artificial intelligence may compel changes in the way insurers may be obliged to defend bad faith claims in the future.

1. Press Release, Ethical AI in Insurance Consortium, 2024 Survey Reveals Crucial Ethical AI Adoption Challenges in Insurance Industry (Mar. 12, 2024) (on file with author).

2. *Id.*

II. A BRIEF HISTORY OF ARTIFICIAL INTELLIGENCE

Artificial intelligence ("AI") is the simulation of human intelligence in machines, allowing them to perform tasks that typically require human cognition.[3] These tasks include learning, reasoning, problem-solving, perception, and language understanding. Algorithms are step-by-step procedures that the AI technology uses to achieve its goal. Algorithms work by taking large sets of data and identifying correlations among different data points; they then use those correlations to make conclusions about the data, predict outcomes, or advise on the best course of action. In essence, AI is powered by algorithms that enable it to process information, adapt, and make intelligent decisions.

Although human analysts can certainly do these things, a well-designed algorithm can do them more efficiently and more effectively than any human. For this reason, AI can be a valuable tool any time a decision requires or is improved by an analysis of the relationship between multiple data points in a large, complex data set.

When AI technology was first introduced, algorithms were developed and refined with the help of a human teacher. A human would assemble a training data set and then analyze, label, or classify the data. The algorithm would learn by example based on the human's analysis or classifications, and then attempt to recreate the human's work when presented with new data. The advent of "machine learning" advanced AI technology to a new level of complexity, allowing algorithms to learn without the guidance of a human teacher.

Algorithms that are taught through machine learning do not require a human teacher or training data; instead, they can go out and find their own data sets, or take a given data set and discover correlations among the data points on their own, without the guidance of a human teacher. These types of algorithms may initially be less accurate than those taught by humans, but many can improve when they receive feedback on their predictions. The advent of machine learning was a huge development in both the power and risk of AI because algorithms could now find correlations among data that a human teacher may have "never defined or even anticipated."[4]

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3. U.S. National Institute of Standards and Technology defines AI as "a machine-based system that can, for a given set of objectives, generate outputs such as predictions, recommendations, or decisions influencing real or virtual environments." NIST, *Artificial Intelligence Risk Management Framework (AI RMF 1.0)*, NIST AI 100-1 1 (2023), https://doi.org/10.6028/NIST.AI.100-1.

4. Alfred R. Cowger, Jr., *Corporate Fiduciary Duty in the Age of Algorithms*, 14 CASE W. RESERVE J.L. TECH. & INTERNET 138, 147 (2023).

III. THE OPPORTUNITIES AND RISKS THAT AI POSES TO THE INSURANCE INDUSTRY

AI has the potential to revolutionize the way the insurance industry "prices, creates, and delivers insurance policies; interacts with customers; and the way it analyzes and evaluates policyholder claims."[5] AI could, for example, evaluate insurance customer calls and questions, identify gaps in coverage or appetite for new coverages based on those questions, draft new policies to fill the gaps, price the coverage, and prepare marketing materials. When designed correctly, AI may also help avoid human bias and potential discrimination in underwriting by limiting the introduction of individual biases into the process.

AI can quickly perform data entry tasks and verify data, allowing for faster processing of a claim. AI also can estimate the cost of a loss to a policyholder, quickly summarize documents and communications, categorize claims by urgency and complexity, automatically resolve and pay simple claims, and recommend settlement decisions and amounts to human claims handlers.[6] Automating these tasks can reduce adjustment expenses to the insurer and shorten the time from the first notice of loss to claim closure. "This is beneficial to the insured both in terms of claim satisfaction and reduced premiums."[7]

AI can also play an important role in rooting out fraudulent claims, which may include claims for losses that never happened, claims containing inflated losses, or claims for losses that the policyholder caused intentionally. AI can be taught to search through internal claims materials for indicia of fraud and can even look quickly through external materials, like social media, for clues.[8] Insurers may save money on these investigations because AI can investigate claims more efficiently and effectively than a human investigator. This also means that insurers can investigate more claims for fraud than previously possible, reducing the number of fraudulent claims it pays out.

While AI generally has great potential for efficiency and cost savings, it is not without risk. "Like any other software, or any other product for that matter, algorithms and AI tools begin with a design process initiated by and

5. Rick Swedloff, *The New Regulatory Imperative for Insurance*, 60 B.C. L. REV. 2031, 2034 (2020).

6. Chris Johnson et al., *AI and Claims Handling: Navigating the Next Wave of Bad Faith Suits*, FOR THE DEF., Nov. & Dec. 2024, at 55, 57–58.

7. Kathleen J. Maus & Julius F. Parker III, *How Carriers Implement Fair Claims Practices in a Hands-Off World*, FOR THE DEF., Oct. 2020, at 18, 19.

8. Swedloff, *supra* note 5, at 2081.

undertaken by humans."[9] Even expert software designers and engineers "are not ever going to be the combination of lawyers, CPAs, business administrators, logistics experts, and HR managers needed to make a good algorithm for use by corporations."[10] For any business using AI, then, expert consultation at the design phase is essential to building an algorithm that is accurate and useful.

The usefulness of AI is necessarily connected to the accuracy of the data sets used to teach the algorithm. That is, if the algorithm is given data that is inaccurate or deficient, its outcomes will be inaccurate and deficient as well.[11] AI taught through machine learning may be more prone to errors because, without the guidance of a human teacher, it is likely to be affected by improperly weighted or unrepresented data.[12] If available data is limited, then the ultimate user of the AI must be able to understand the AI's limitations in order to use it appropriately.[13] For most people, this is a tall order—algorithms are generally not particularly transparent, so it is difficult to track or observe the process it uses to accomplish its tasks.[14] Even AI experts may not fully understand how a particular algorithm operates.[15]

During the design phase, an algorithm's potential for accuracy and usefulness must be weighed against potential development and operating costs. Developing AI is not cheap, and the cost of training advanced AI systems has been increasing for years due to a rise in labor costs and the costs of necessary semiconductors, among other factors.[16] It is generally cost prohibitive to develop an algorithm that gives an accurate answer to every question, or performs every task perfectly, so some error rate should always be expected.[17] Additionally, AI developers must consider the technology's operating costs to its users. AI requires a significant amount of energy to operate—AI technology used by bitcoin businesses can use "more energy than entire

9. Cowger, *supra* note 4, at 140.

10. *Id.*

11. Michael Luca et al., *Algorithms Need Managers, Too*, HARV. BUS. REV., Jan.–Feb. 2016.

12. Cowger, *supra* note 4.

13. Luca et al., *supra* note 11.

14. *Id.*

15. Cowger, *supra* note 4, at 149.

16. Will Henshall, *The Billion-Dollar Price Tag of Building AI*, TIME MAG. (June 3, 2024, 3:22 PM), https://time.com/6984292/cost-artificial-intelligence-compute-epoch-report/.

17. *Id.* ("The push to build more computationally intense AI systems could be bottlenecked by the intense energy requirements of the largest clusters of semiconductor chips or by a lack of training data.").

nations."[18] Even a very sophisticated AI product, then, may not be viable for regular use if it requires too much energy to operate.

The algorithm's design can also be negatively affected by the biases of its designer. While many assume that AI is free of bias—it is a machine, after all—in reality, it can simply build into its operation any bias of its human designers or bias in the data set used to train the algorithm.[19] "In a worst-case scenario, if the customer wants a discriminatory result, the designer can deliver an algorithm that will produce such a result while seemingly making non-human, unbiased analyses."[20] In a marginally better scenario, data often reflects historical discrimination and, without intervention from a human designer, will teach the AI to continue or potentially expand discriminatory practices.[21]

Despite the potential for error in the algorithm design process, many human users of AI technology are biased in its favor. "Studies have repeatedly shown that humans exhibit 'automation bias' in favor of AI, which means humans tend to accept an algorithmic outcome, even if they intuitively suspect there is something wrong with the outcome. Even experts, who should have enough knowledge and experience to know when an algorithmic answer is wrong, tend to reject their own self-doubt in favor of the erroneous algorithmic-based results."[22] Thus, good human judgment is, ironically, an essential component for making the best possible use of AI.[23]

IV. WILL ARTIFICIAL INTELLIGENCE GENERATE NEW BAD FAITH CLAIMS?

As we have seen, artificial intelligence is an increasingly integral aspect of insurance claims operations. We will now consider whether, and how,

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18. Cowger, *supra* note 4, at 141.

19. Jake Silberg & James Manyika, *Tackling Bias in Artificial Intelligence (and in Humans)*, MCKINSEY GLOB. INST. (June 6, 2019), https://www.mckinsey.com/featured-insights/artificial-intelligence/tackling-bias-in-artificial-intelligence-and-in-humans ("[S]ome evidence shows that algorithms can improve decision making, causing it to become fairer in the process . . . . At the same time, extensive evidence suggests that AI models can embed human and societal biases and deploy them at scale.").

20. Cowger, *supra* note 4, at 141.

21. NIST, *Artificial Intelligence Risk Management Framework: Generative Artificial Intelligence Profile*, NIST AI 600-1 4 (2023), https://doi.org/10.6028/NIST.AI.600-1.

22. Cowger, *supra* note 4, at 140.

23. Silberg & Manyika, *supra* note 19.

the emerging role of AI may, in turn, generate bad faith claims against insurers. In particular, it is foreseeable that such claims may be brought based on: (1) faulty design of AI products that results in discriminatory or unfair results; (2) negligent human oversight of AI components; or (3) improper use or abuse of AI to deny claims.

A. DESIGN ISSUES

The risks associated with insurers' use of AI may arise from the design of the algorithm and/or from the use of the AI technology.

One important design consideration relates to the feedback the AI receives when it is used to settle claims. One author posited (without any citation or support) that "[t]he insurer likely instructs the AI to pay the lowest reasonable amount for a claim."[24] The author theorized that if these offers are regularly rejected by policyholders, the AI receives negative feedback on its settlement offers and learns to propose higher settlement amounts.[25] If, however, policyholders routinely accept the offers, the AI receives no negative feedback and, the author suggests, will offer the same or a lower amount to the next policyholder with a similar claim.[26]

A lack of complaints from policyholders may indicate that the AI's settlement offers are fair and reasonable, but this is not necessarily the case. There are many reasons why a policyholder may accept a low settlement offer: it may not be low enough for the policyholder to complain; it may be too costly to fight with the insurer or switch carriers; or the policyholder may not realize the offer is low.[27] The author fails to recognize, however, that if policyholders are dissatisfied with low offers and frustrating claims processes, corrective actions may include policyholders changing carriers and filing bad faith lawsuits alleging systematic underpayment of claims.

An insurer could also face a bad faith claim if it uses inaccurate data to train its AI or misrepresents the way its AI operates. An insurer is currently facing a bad faith suit by the State of California alleging bad faith arising from both putative practices.[28] In its complaint, filed in April 2024, the State of California alleges that Progressive violated the covenant of good faith and fair dealing by engaging in a scheme to systematically underpay its policyholders for claims of total vehicle losses. The complaint alleges that Progressive

24. Swedloff, *supra* note 5, at 2082.

25. *Id.*

26. *Id.*

27. *Id*.

28. Complaint, People v. Progressive Corp., No. 24CV073476 (Cal. Super. Ct. Almeda Cty. filed Apr. 29, 2024).

purposefully customized its loss valuation software to generate a Market Value Report (MVR) for each loss reported, and then misrepresented that amount as the Actual Cash Value (ACV) for the vehicle, knowing that the MVR would produce a lower settlement amount than the ACV. The complaint alleges that the defendants engaged in this scheme to induce policyholders to accept lower settlement amounts for their losses. The State of California is seeking statutory damages upwards of $2,500 per violation of state law, as well as disgorgement of any profits Progressive gained from this scheme. As of February 2025, the case is pending in California Superior Court in Alameda County.

A bad faith claim might also arise if the use of AI results in claims decisions based on factors that, by law, insurers are forbidden to consider. In December 2022, two named plaintiffs filed a putative class action lawsuit in Illinois federal court against insurer State Farm, alleging race-based practices in the handling of their home insurance claims.[29] The plaintiffs, who are both Black, contend that State Farm took longer to process their claims, required more paperwork, and ultimately provided less coverage than it did to their white neighbors, who were also State Farm policyholders and whose homes suffered similar damage. Rather than alleging discriminatory animus, the plaintiffs claim that State Farm used "algorithmic decision-making tools that allegedly resulted in statistically significant racial disparities in how the insurer processed claims," in violation of the Fair Housing Act (FHA).

State Farm moved to dismiss the suit, but the court found that the plaintiffs had adequately stated a claim under a disparate impact theory.[30] The court found that "State Farm's decision to use algorithmic decision-making tools to automate claims-processing" constituted a "policy" under the FHA. It further found that the plaintiffs had plausibly alleged a connection between State Farm's use of AI and statistical racial disparities in claims handling by "describing how machine-learning algorithms—especially antifraud algorithms—are prone to bias."[31] Although the plaintiffs did not assert a claim for bad faith in their complaint, the court noted that "[l]iability under the FHA for processing Black policyholders' claims differently aligns with State Farm's state-law obligation to 'effectuate prompt, fair and equitable settlement of claims' in good faith."[32] Thus, even if a plaintiff could not prevail under state or federal antidiscrimination law, a bad faith claim based on similar facts would be plausible. As of February 2025, the case is in discovery.

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29. Complaint, Huskey v. State Farm Fire & Cas. Co., No. 1:22-cv-07014 (N.D. Ill. filed Dec. 14, 2022).

30. Huskey v. State Farm Fire & Cas. Co., No 22 C 7014, 2023 WL 5848164, at *1 (N.D. Ill. Sept. 11, 2023).

31. *Id.* at *9.

32. *Id.* at *11 (quoting 215 ILL. COMP. STAT. 5/154.6(d) (2022)).

Careful vetting of AI vendors, understanding the data used to teach the AI, and appreciating how the algorithm's function can be manipulated throughout its lifecycle are essential to assessing bad faith risks. The algorithm design process may aim to use AI to efficiently produce results that are consistent with the insurance policy. A bad faith claim might allege that the insurer improperly attempted to produce results aligned with pre-loss predictions or projections, which could conflict with its contractual duty to fairly investigate and value each claim. Indeed, jurors tend to find that insurers act in bad faith when they use AI to prioritize their own cost savings over the interests of their policyholders.[33]

Working closely with algorithm designers to ensure AI functions consistently with the covenant of good faith and fair dealing may help avoid issues down the line. Similarly, incorporating policy terms into the algorithm so its decisions align with those terms may reduce the risk of bad faith allegations.

While intentionally teaching a claims handling algorithm to consider protected characteristics, such as race or gender, would violate the insurer's duty to investigate each claim fairly and in good faith, the complexity of machine learning from large data sets introduces additional challenges. For decades, proxy characteristics, which are "purportedly neutral individual characteristics" whose consideration frequently results in racial disparities, have been used where direct discrimination is prohibited.[34] The National Association of Insurance Commissioners (NAIC), in its Principals on Artificial Intelligence, recommends that insurers avoid "proxy discrimination against protected classes" in their design of AI to avoid even unintentional discrimination. Thus, working with AI designers to prevent algorithms from relying on data that might perpetuate historical discrimination, whether through the use of protected characteristics or proxies, may help avoid liability under both bad faith and anti-discrimination law.

B. OVERSIGHT CONCERNS

Courts may also hold insurers liable for not properly monitoring or auditing AI models, especially if these systems systematically underpay claims. In such cases, insurers might be required to demonstrate that their AI complies with industry best practices, ensuring unbiased and reliable decision-making. AI systems that unintentionally discriminate against

33. Johnson et al., *supra* note 6, at 58.

34. Cal. Dep't of Ins., Bulletin 2022-5, *Allegations of Racial Bias and Unfair Discrimination in Marketing, Rating, Underwriting, and Claims Practices by the Insurance Industry* (June 30, 2022).

policyholders based on factors like race, age, or location could result in bad faith claims, with policyholders arguing insurers failed to prevent biased denials.

C. CLAIMS HANDLING ISSUES

In addition to designing their AI systems with their legal and contractual obligations in mind, parties must carefully consider how and when insurers are actually using AI technology throughout the claims process. An insurer may face increased risk of a bad faith claim if it is inconsistent in its use of AI.

Back in 2010, before the advent of AI as we know it today, Allstate Insurance came under fire for its use of an internal claims handling program known as Colossus.[35] The NAIC, along with the insurance departments of forty-five states, investigated Allstate's use of Colossus and found that Allstate was inconsistent in the way it used Colossus to review and manage car accident claims.[36] The probe also found that Allstate was not transparent with its use of Colossus. Allstate settled the matter, agreeing to pay $10 million to the states involved in the probe.[37] Allstate also agreed to strengthen its internal auditing of Colossus, develop a single manual for internal use of Colossus, and refrain from establishing policies that would force Allstate's claims adjusters to settle claims based solely on recommendations from Colossus.[38]

As the Allstate settlement demonstrates, an insurer might increase its litigation exposure when it makes a claims decision, particularly a denial, based solely on AI analysis.[39] Several health insurance companies are currently defending class actions alleging that the insurers used AI to avoid obligations to give each claim individualized consideration and to improperly deny patient claims. In April 2024, four named plaintiffs filed a putative class action suit against health insurer Humana in Kentucky federal court, alleging that Humana used a predictive AI model to wrongfully deny post-acute care to elderly patients under their Medicare Advantage Plans.[40] In the complaint, the plaintiffs allege that Humana used its AI model, known as nH Predict, to

35. Ben Berkowitz, *Allstate Settles with States over Claims Software*, REUTERS, Oct. 18, 2010, https://www.reuters.com/article/world/uk/allstate-settles-with-states-over-claims-software-idUSTRE69H4DJ/.

36. *Id.*

37. *Id.*

38. *Id.*

39. Johnson et al., *supra* note 6, at 57–58.

40. First Amended Complaint, Barrows v. Humana, Inc., No. 3:23-cv-00654-RGJ (W.D. Ky. filed Apr. 22, 2024).

override the decisions of treating physicians and deny medically necessary care to patients, resulting in a high rate of wrongful deaths. The plaintiffs allege that Humana implemented nH Predict because the majority of Humana's policyholders lack the resources, capacity, or knowledge to appeal the denied claim. The complaint pleads claims of bad faith, common-law fraud, breach of contract, and various violations of state law. Humana states that the company uses "various tools, including augmented intelligence to expedite and approve utilization management requests," and "maintains a 'human in the loop' decision-making whenever AI is utilized."[41] Humana filed a motion to dismiss and as of February 2025, that motion is pending.

Nearly identical claims were filed in April 2024 in a separate suit against health insurer UnitedHealth Group in Minnesota federal court.[42] UnitedHealth filed a motion to dismiss, arguing that the plaintiffs failed to exhaust their administrative remedies by appealing UnitedHealth's coverage decisions as required by the Medicare Act.[43] UnitedHealth further argued that the plaintiffs' claims were preempted by the Medicare Act. In February 2025, the court granted UnitedHealth's motion in part and denied it in part. The court agreed that the plaintiffs were required to exhaust their administrative remedies but waived the requirement on futility grounds. The court dismissed the plaintiff's statutory claims as well as its bad faith claim, agreeing with UnitedHealth that these claims were preempted by the Medicare Act. A finding of liability on bad faith, the court found, would require it to determine whether UnitedHealth's denial of coverage was reasonable, and the reasonableness of a coverage decision related to a Medicare advantage plan was already regulated by the Medicare Act. The court allowed the plaintiff's claims for breach of contract and breach of the covenant of good faith and fair dealing to continue, finding those claims were not preempted by the Medicare Act because they only required the court to apply basic contract law principles to UnitedHealth's own written documents. For now, then, it seems that in the health insurance space, the interplay of an insurer's contractual obligations and the Medicare Act will be significant in determining how the insurer fares in a bad faith claim centered on the use of AI.

In June 2024, six named plaintiffs filed a putative class action suit against health insurer Cigna in California federal court for allegedly using AI

41. Elizabeth Napolitano, *Lawsuits Take Aim at Use of AI Tool by Health Insurance Companies to Process Claims*, MONEYWATCH (Dec. 18, 2023), https://www.cbsnews.com/news/health-insurance-humana-united-health-ai-algorithm/.

42. First Amended Complaint, Estate of Lokken v. UnitedHealth Grp., Inc., No. 0:23-cv-03514-JRT-DTS (D. Minn. filed Apr. 5, 2024).

43. Mem. Op. & Ord., Estate of Lokken v. UnitedHealth Grp., Inc., No. 0:23-cv-03514-JRT-DTS (D. Minn. filed Feb. 13, 2025).

to evade the legally-mandated individual physician review process.[44] In their complaint, the plaintiffs allege that Cigna used an algorithm, known as PXDX, to instantly and automatically deny payments for patients whose prescribed treatments did not match certain pre-set criteria. Plaintiffs allege that PXDX allowed Cigna to deny claims in batches of hundreds of thousands at a time, allowing the insurer to reject claims on medical grounds without ever giving the patient's claim individualized consideration. The complaint pleads claims under the Employee Retirement Income Security Act (ERISA) and California's unfair competition law, the latter including allegations of bad faith. Cigna moved to dismiss the claim, and that motion remains pending as of February 2025.

These examples highlight the need for selective and consistent use of AI technology, understanding that AI is not appropriate for every task in the claims handling process. Outsourcing certain tasks to AI, such as summarizing documents or processing and verifying data, likely pose little to no risk to insurers. AI may also be useful as a tool to automatically pay out simple claims, because a policyholder who quickly receives payment of insurance proceeds is unlikely to sustain damages to support a bad faith claim.[45] Outsourcing other tasks to AI, like making a coverage decision on a large or complex claim, may be much riskier. Insurers could nonetheless benefit from using AI to easily and quickly identify complex claims or those at high risk of future bad faith suits and then route them to an experienced claims handler.[46]

Referencing the transparency issue in the Allstate case discussed above, not disclosing AI use in claims processing may indicate bad faith if policyholders cannot understand, challenge, or appeal AI claims decisions. Courts could rule that lack of transparency prevents fair contestation of denials. Policyholders could argue that unexplained AI denials suggest improper adjusting. Courts might require justifiable reasons for AI-driven claims denials, similar to conventional claim denials. As such, insurers can avoid bad faith exposure by clearly explaining AI-based decisions. Another issue can arise when AI makes fully automated claims decisions without human oversight. If AI denies claims without human review or override, in some states insurers may be violating fair claims handling practices.

Insurers that are developing internal policies and claims handling manuals to guide their human adjusters to use AI appropriately may need to revisit those policies as technology advances. Denials of claims based on AI

44. Third Amended Complaint, Kisting-Leung v. Cigna Corp., No. 2:23-cv-01477-DAD-CSK (E.D. Cal. filed June 14, 2024).

45. Smith v. Allstate Ins. Co., 904 F. Supp. 2d 515, 521 (W.D. Pa. 2012).

46. Maus & Parker, *supra* note 7, at 22–23.

alone have given rise to bad faith claims against insurers.[47] Internal auditing of procedures may help confirm that they are being followed.

V. WILL ARTIFICIAL INTELLIGENCE AFFECT HOW BAD FAITH CLAIMS ARE DEFENDED?

Finally, the very complexity of AI may complicate the ability of insurers to defend against AI/bad faith claims. As such, the use of AI in insurance claims processing is likely to change or generate new insurance bad faith law in response to concerns over fairness, transparency, and accountability.

Insurers that use AI—whether in underwriting, claims, or other insurance functions—may face new challenges in the defense of bad faith claims. Many theories of liability will not be new, as bad faith claims related to the use of AI are likely to build off of claims related to the use of other types of automated software.[48] However, unique aspects of AI will bring new challenges into the courtroom.

For one, the complexity of sophisticated AI technology makes it difficult to explain to jurors.[49] Jurors historically have tended to be skeptical of AI in general because they do not understand it and prefer to see a human touch involved in the claims handling process.[50] Query, though, whether jurors who increasingly use AI in their own lives and rely on it for everything from driving directions to home temperature control will have a base level of skepticism. Nonetheless, both parties in a litigation concerning the use of AI will likely need to hire expert witnesses to testify about how the algorithm was designed and how it works.[51] Soliciting relevant and helpful testimony, even from an AI expert, is not as simple as it may seem. AI is unique from other automated software in that the "Black Box nature of the entire algorithmic process would preclude knowing exactly how, when, and why" a problem with the AI occurred.[52] Frequently, the AI engineers themselves do not know exactly how the algorithm works or even what factors it considers in its decision-making process.[53] For this reason, an AI expert who is well-suited for the courtroom may be expensive and hard to come by.

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47. Cowger, *supra* note 4, at 140.
48. Johnson et al., *supra* note 6, at 57.
49. *Id.* at 58.
50. *Id.*
51. *Id.*
52. Cowger, *supra* note 4, at 149.
53. Swedloff, *supra* note 5, at 2078.

Just how the use of AI in insurance claims processing will significantly impact how insurance bad faith cases are tried to a jury remains to be seen. With respect to the complexity of AI evidence and jury comprehension, AI-driven decision-making is highly technical, requiring expert testimony to explain how an algorithm processes claims. Jurors may struggle to understand AI mechanics, leading to reliance on simplified narratives provided by attorneys. Imagine policyholders framing AI as a "black box" that unfairly denies claims as opposed to insurers arguing that AI improves accuracy and reduces human bias. Expect more expert witnesses (data scientists, AI ethicists, insurance actuaries) to explain AI models. Policyholders may utilize simplified analogies (e.g., "the AI was like a rigged slot machine"). Judges may allow jury instructions addressing AI transparency and fairness.

There is a likelihood that the bad faith focus will shift from an individual adjuster's subjective intent to corporate AI systems and decision-making. Policyholders might argue that the insurer designed its AI system to minimize payouts, creating systemic bad faith (e.g., "institutional bad faith") rather than case-by-case misconduct. If so, insurers will need to defend AI algorithms as fair, unbiased, and compliant with industry standards.

The use of AI in insurance claims processing is anticipated to impact pretrial discovery in insurance bad faith cases, resulting in more data-intensive and complex litigation with a focus on algorithmic decision-making. Insurers should prepare for increased requests for AI-related data and internal decision logs as policyholders seek detailed records of how the AI influenced claim resolutions. Courts may require insurers to produce AI system logs, training data, and decision rationales, including correspondence between insurers and AI vendors regarding claims processing. While insurers may contend that their AI models are trade secrets and thus protected from discovery, courts could still mandate the disclosure of AI decision-making records if they directly impacted the claim decisions in question. In cases of institutional bad faith, policyholders might request emails, internal reports, and compliance audits to demonstrate that insurers were aware of AI-driven unfairness. This scenario foretells substantial e-discovery demands, including requests for training documents related to human adjusters reviewing AI-generated recommendations.

Traditional bad faith cases typically involve deposing claims adjusters; however, with AI, liability may shift to corporate decision-makers and data scientists. Consequently, policyholders may seek depositions from AI engineers, compliance officers, and corporate executives overseeing AI deployment. Conversely, insurers may argue that AI developers should not be deposed since they do not make individual claim decisions and insist that executive depositions are unnecessary unless bad faith is unequivocally established.

Litigators should consider the effects that state AI regulations may have on AI-driven bad faith discovery. For instance, in states adopting the NAIC Model Bulletin on AI Usage, insurers are required to develop, implement, and maintain written programs for the responsible use of AI systems. This includes establishing governance frameworks, risk management protocols, and internal controls to ensure AI systems are utilized responsibly throughout the insurance lifecycle, including claims adjudication.

The deployment of AI in insurance claims processing will significantly influence the role of expert witnesses in insurance bad faith cases. Historically, adjusters and claims supervisors explained the human-based decision process behind claims decisions. In contrast, AI-driven bad faith cases likely will require experts to elucidate how AI systems reached a claim decision or provided recommendations to adjusters. This shift necessitates new types of expertise, expanded roles, and more complex testimony.

Traditional insurance bad faith trials typically involve claims handling experts and industry standards experts. However, AI-driven claims processing cases will introduce new categories of expert witnesses. AI and machine learning experts may be called upon to explain the functioning of AI models, including aspects such as biases, fairness, and decision-making logic. Data scientists and algorithm auditors might analyze AI-driven claims denials, assessing whether the system systematically underpays claims. Ethical AI experts could be utilized to argue that an AI system violated fairness principles or discriminated against certain policyholders. Additionally, cybersecurity and compliance experts may support claims that an insurer failed to adhere to AI governance and regulatory standards.

All of these factors can result in more complex trials and increased costs for both policyholders and insurers. As the use of AI in insurance continues to grow, judges will need to determine the appropriate weight to assign to expert testimony concerning AI fairness, transparency, and compliance.

Ultimately, to succeed in defending a bad faith claim, the insurer must show a court that its use of AI software was reasonable.[54] Insurers might argue that AI eliminates human bias, ensuring consistent and fair claims handling. They could use AI data to show consistency in claim valuations, weakening policyholders' bad faith arguments. If AI makes fact-based, rules-driven decisions, insurers may claim it acted in good faith using objective criteria. Some courts have found that these are a question of fact best resolved by a jury, meaning it cannot be resolved on summary judgment at less expense to both parties.[55]

54. Johnson et al., *supra* note 6, at 57.

55. *See* Lewis v. Allstate Ins. Co., No. 3:15-cv-8074-HRH, 2016 WL 5408332, at *5 (D. Ariz. Sept. 28, 2016).

VI. CONCLUSION

As may be seen, the implementation of AI is not without its challenges. Insurers must ensure that their AI systems are designed and deployed responsibly, with a focus on transparency, fairness, and compliance with regulatory requirements. The potential for bias in AI algorithms is a significant concern, as it can lead to unfair treatment of certain policyholders. Therefore, insurers must take proactive measures to mitigate these risks and ensure that their AI systems operate in an ethical and lawful manner.