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Saul Ewing LLP

Insurance Practice

The Bad Faith Sentinel

Standing guard on developments in the law of insurance bad faith around the country

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Eastern District of Pennsylvania: Insurer's "Paid When Incurred" Practice is Not Bad Faith or a Violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law

Pellegrino v. State Farm Fire and Cas. Co., No. 12-2065, 2013 WL 3878591 (E.D. Pa. July 29, 2013).

The Eastern District of Pennsylvania held that insurer could withhold payments under its "paid when incurred" practice until repairs to undamaged property that needed to be replaced to match damaged portions of property were complete. The insurer's refusal to pay actual cash value for those repairs did not support a claim of bad faith or violation of the Pennsylvania Unfair Trade Practices and Consumer Protection Law as the policy obligated the insured only to pay to repair damaged property.

In March 2011, the siding and roof of Louis and Christine Pellegrino's home was damaged by a storm. The Pellegrinos hired an adjuster, who determined the total cost of repairs to be $80,443.13, including the total replacement of the roof and siding. The Pellegrinos' home was covered by a homeowner's insurance policy issued by State Farm Fire and Casualty Company ("State Farm"). Under the policy, State Farm agreed to pay the cost "to repair or replace with similar construction," however State Farm would only pay the actual cash value once actual repair or replacement was completed. State Farm concluded that that covered damage included three of the four sides of the house, as well as thirty square feet of the roof. State Farm estimated the "Total Amount of Claim if Incurred" to be $43,711.21, which was divided into $17,091.58 to be paid to the Pellegrinos as the actual cash value payment, and $26,619.63 to be "paid when incurred."

State Farm determined that it could not replace the damaged portions with products that matched the color, size and texture of the undamaged portions. State Farm asserted that it was not contractually obligated to pay for any undamaged portion of the property, but that it would pay for the "paid when incurred" ("PWI") costs as a matter of customer service. The policy did not contain the term "paid when incurred,"

however State Farm's estimate defined it as "items which may not be necessary in the repair of your property damaged by a covered loss." The Pellegrinos, however, insisted that State Farm was required to "repair or replace with similar construction" and consequently, sought the actual cash value payment for both the damaged and undamaged portions of the roof and siding as it would all have to be replaced to ensure a consistent color and appearance.

The Pellegrinos filed suit seeking the actual cash value of the entire roof and all siding, and alleged that State Farm's practice of categorizing repairs as "paid when incurred" constituted a breach of contract, bad faith and a violation of the Unfair Trade Practices and Consumer Protection Law ("UTPCPL"). The panel concluded that the policy was unambiguous and clearly stated that State Farm was obligated only to pay for the damaged part of the property. Moreover, the policy limited payment of the actual cash value to "the damaged part of the property." Thus, State Farm was contractually obligated only to pay for the portion of the shingles and siding that were damaged. The additional costs to match or "repair or replace with similar construction" would be a second step, which would be paid after repair or replacement was completed.

The Eastern District indicated that Pennsylvania precedent on the issue of whether the insurer was required to match the roof and siding for purely aesthetic purposes was unclear, however the issue was moot as State Farm had agreed to pay for matching once the repair was complete and because any concern that the property would lose value if the repaired portions did not match would only arise after the repair was made. The court held that to require State Farm to pay costs to match the shingles and siding to insureds who did not intend to repair the property would not indemnify for a loss, but would result in a windfall. Accordingly, the court found that there was no bad faith claim as State Farm's practice of withholding insurance proceeds on a "paid when incurred" basis did not breach the policy. The court also determined that the UTPCPL claim failed because it was not deceptive for State Farm to adhere to the unambiguous language of the policy, and to pay according to its terms.

California Court of Appeal: Insurer May Commit Bad Faith by Interpreting a Policy Provision in Direct Conflict with an Unpublished Decision by Appeal Court in the Same State on the Same Issue

***Verniero v. Allstate Insurance Company*, No. B236212, 2013 WL 3815246 (Cal. App. 2 Dist. July 22, 2013).**

California Court of Appeal concludes that a bad faith action may lie against an insurer when it takes the position that a policy provision is unambiguous after receiving an opposite order from an unpublished court of appeal decision on the same issue.

Plaintiffs John Verniero and his wife Maria Calabrese ("Verniero and Calabrese") suffered water damage in their home as a result of an underground water pipe that burst just outside of their home's foundation. Allstate Insurance Company ("Allstate") provided coverage to Verniero and Calabrese under a "Deluxe Plus Homeowners Policy" that insured direct physical loss to the "dwelling including the attached structures." Allstate denied Verniero and Calabrese's claim as falling under an exclusion that the loss was not caused by the failure of a plumbing system within its "dwelling."

Verniero and Calabrese argued that coverage should be provided because "within your dwelling" is ambiguous under its policy with Allstate. Allstate took the position that "within your dwelling" modifies the policy such that water damages must be caused by an incident within Verniero and Calabrese's dwelling, and because the pipe failure occurred just outside of the home's foundation, the policy did not provide coverage. Verniero and Calabrese argued that the pipe burst was within their "dwelling" because the location of the pipe break was underneath an overhang of the roof.

The trial court ruled that the term "dwelling" was unambiguous in the context of the policy – the pipe burst occurred outside of the dwelling and therefore there was no coverage under the Allstate policy. The California Court of Appeal overturned the trial court's decision in favor of Allstate by concluding that "dwelling" was ambiguous, which therefore triggered coverage because ambiguity is to be construed against the insurer.

Verniero and Calabrese argued that Allstate committed bad faith because it never should have taken the position that "dwelling" unambiguously did not provide coverage because the California Court of Appeal, in an unpublished decision, already ruled that the same provision is ambiguous. While the Court of Appeal declined to find that Allstate committed bad faith, it concluded that there were sufficient facts to support a bad faith claim against Allstate.

The Court of Appeal concluded that a jury could find Allstate committed bad faith despite the fact that the trial court independently concluded that the policy provision was unambiguous, and despite the fact that the previous case addressing this issue was an unpublished decision. Specifically, the Court of Appeal found that discovery is warranted and a jury may find that Allstate committed bad faith because: (1) a court already determined the same policy language was ambiguous; and (2) Allstate argued in the present case that the disputed language unambiguously meant something different than what Allstate previously argued it unambiguously meant in the prior case.

California Supreme Court Permits Claims Based on Conduct that Violates Both the Unfair Insurance Practices Act and Other Statutes to Proceed

***Zhang v. Superior Court of San Bernardino County, et al,* No. S178542, 57 Cal. 4th 364 (Cal. Aug. 1, 2013).**

The California Supreme Court explains that while private causes of action based on violation of the California Unfair Insurance Practices Act are absolutely barred, claims based on conduct that violates both the UIPA and other statutes or the common law may lie.

After California Capital Insurance Co. (CCIC) refused to authorize what she believed was an adequate payment for fire damage to a commercial premises she owned, Yanting Zhang sued the company in the San Bernardino County Superior Court. Zhang's complaint included causes of action for breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of the California Unfair Competition Law ("UCL"). In her UCL claim, Zhang alleged that CCIC had engaged in unfair and deceptive advertising by promising to provide timely coverage in the event of a compensable loss when it had no intention of paying the true value of its insureds' covered claims. CCIC filed a demurrer to the UCL claim, arguing that it was an attempt to plead around the prohibition of private actions under the California Unfair Insurance Practices Act ("UIPA") established in *Moradi-Shalal v. Fireman's Fund Ins. Co.*, 46 Cal. 3d 287 (Cal. 1988). The trial court agreed and sustained the demurrer without leave to amend. The appellate court reversed, holding that Zhang's false advertising claim was a viable basis for a UCL cause of action. CCIC sought review of the appellate court decision.

The California Supreme Court held that *Moradi-Shalal* does not preclude first party UCL actions based on grounds independent from the UIPA, even when the insurer's conduct also violates the UIPA. The Court explained, "We have made it clear that while a plaintiff may not use the UCL to 'plead around' an absolute bar to relief, the UIPA does not immunize insurers from UCL liability for conduct that violates other laws in addition to the UIPA." Because Zhang's alleged causes of action for false advertising and bad faith provided grounds for a UCL claim independent from the UIPA, the Court found that her claims were "quite distinct" from the claims with which *Moradi-Shalal* was concerned.

Missouri Court Dismisses Bad Faith Claim Tied to Same Conduct Giving Rise to Insured's Breach of Contract Claim

The Hullverson Law Firm, P.C., et al v. Liberty Ins. Underwriters, No. 4:12-cv-1994-CAS, 2013 WL 3802517 (E.D. Mo. Jul. 22, 2013).

Missouri law does not permit an insured to bring claims for both breach of contract or vexatious refusal to pay and for bad faith if those claims are premised on the same alleged misconduct.

In January 2012, the Hullverson Law Firm and certain of its attorneys (collectively, "the Firm") were sued for various activities related to the Firm's advertising. The 56-page complaint filed against the Firm alleged that it had violated the Missouri Rules of Professional Conduct and the Lanham Act. The Firm denied liability and requested that Liberty defend and indemnify it pursuant to the Firm's lawyers professional liability insurance policy. After Liberty denied coverage, the Firm filed a four-count complaint against Liberty seeking declaratory relief and asserting claims for breach of contract, vexatious refusal to pay pursuant to Missouri statute, and "bad faith failure to defend and indemnify."

Liberty filed a motion to dismiss the bad faith claim arguing that the claim was preempted by the Firm's claim under Missouri's vexatious refusal to pay statute. The Firm argued that its bad faith claim was a third-party claim based on conduct distinct from the conduct that constituted breach of conduct, and that Missouri courts have not held that third-party claims are preempted by the statute.

The district court explained that Missouri law "is clear" that a denial of coverage is actionable only as a breach of contract and, where appropriate, as a claim for vexatious refusal to pay. A Missouri plaintiff complaining of breach of contract cannot also bring a tort claim dependent on the same elements as the contract claim. The district court then turned to the Firm's complaint to examine the facts alleged in support of its claims for breach of contract, vexatious refusal to pay and bad faith. The court concluded that the Firm alleged no independent facts in the bad faith claim, but rather, adopted and incorporated all of the facts from the breach of contract and vexatious refusal to pay claims. Because the bad faith claim was not "wholly independent" of the breach of contract and vexatious refusal to pay claim, the court dismissed the claim.

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