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Contacts:

Carolyn Due
202.295.6613
cdue@saul.com

Matthew M. Haar
717.257.7508
mhaar@saul.com

Joseph C. Monahan
215.972.7826
jmonahan@saul.com

Amy L. Piccola
215.972.8405
apiccola@saul.com

Thomas S. Schaufelberger
202.295.6609
tschaufelberger@saul.com

Saul Ewing LLP

Insurance Practice

The Bad Faith Sentinel

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

Contents

Texas Court of Appeals: Trial Court Must Sever Breach of Contract and Bad Faith Claims Following an Insurer's Offer to Settle

In re State Farm Mutual Auto. Ins. Co., No. 08-12-00176-CV, 2012 WL 3195099 (Tex. App. Aug 8, 2012)

A trial court must sever the insured's extra-contractual claims from the contract claims following an insurer's offer to settle because evidence of settlement creates prejudice.

Rosa Duran was injured by an underinsured motorist while walking through a shopping center parking lot. After recovering insufficient compensation from the motorist, Rosa made a claim on two separate policies issued by State Farm Mutual Automobile Insurance Company ("State Farm") – one issued to her husband and the other issued to her daughter. State Farm offered the Durans $7,500 to settle both claims. The Durans rejected the offer and instead sued State Farm for breach of the insurance policy, violations of the Texas Deceptive Trade Practices Act, and violations of common-law duty of good faith and fair dealing. State Farm moved for severance of the Durans' extra-contractual claims from their contract claim, and for abatement of their extra-contractual claims pending resolution of the contract claim. The trial court denied State Farm's motion and State Farm petitioned the Court of Appeals of Texas for interlocutory mandamus relief.

Mandamus relief is only appropriate when a trial court clearly abuses its discretion and the benefits of mandamus are significant. The Court of Appeals granted mandamus relief. Severance is not mandatory when there are contractual and extra-contractual claims; however, a trial court must sever the claims when an insurer so moves following its offer to settle the contractual claims. The Court noted that absent severance, an insurer is presented with a Catch-22. An insurer will move to exclude evidence of settlement when defending the contractual claim because such evidence suggests liability. However, in defending a bad faith claim, an insurer will seek to have evidence of settlement admitted so as to negate liability. By having to defend the two claims simultaneously before the same jury, an insurer is thereby unfairly prejudiced. Therefore, severance of the claims is required after an insurer offers to settle the contractual claims.

Although the trial court was required to sever the claims, it was not required to abate extra-contractual claims until the contract claim was decided. A trial court may decide that the extra-contractual claims should be abated if the abatement will: (1) promote justice; (2) avoid prejudice; and (3) promote judicial economy. In order to establish that the extra-contractual claims should be abated, State Farm bore the burden to show that: (1) defending against the contract claims clashed with defending against the extra-contractual claims; and (2) abating the extra-contractual claims promotes justice, avoids prejudice, and promotes judicial economy.

The Court of Appeals found that the record did not contain evidence establishing specifically how the trial court's failure to abate would prejudice State Farm and promote justice. The Court of Appeals noted that, as an example, there was no evidence to show that if the extra-contractual claims were not abated that State Farm would be hampered in its ability to conduct full and complete discovery or that it would have to prepare for simultaneous trials. Instead, State Farm relied on its conclusory petition. Accordingly, the Court of Appeals upheld the trial court's refusal to abate the extra-contractual claims.

Third District Court of Appeals of Florida Holds that Discovery of Insurer's Business Practices is Premature Before Determination of Coverage

***General Star Indem. Co. v. Atlantic Hospitality of Florida, LLC.*, No. 3D11-3199, 2012 WL 3023162 (Fla. Dist. Ct. App. July 25, 2012)**

Court of Appeals of Florida upheld insurer's objections to discovery of training manuals, company policy memoranda, and other business practices as premature because liability had not yet been determined.

General Star Indemnity Company ("General Star") issued a commercial property insurance policy to Atlantic Hospitality of Florida, LLC ("Atlantic"). General Star paid Atlantic $1.4 million on its claim for property damage caused by Hurricane Charlie. Atlantic subsequently filed an action against General Star for additional funds and asserted claims for breach of contract, declaratory judgment, and breach of the implied contract of good faith and fair dealing.

During discovery, Atlantic requested, among other documents, the production of "[a]ll training manuals, company policy memoranda, and guidelines relating to the underwriting and administration of the subject insurance policies and/or estimating, adjusting, and payment of claims under the subject insurance policies." General Star objected to the production of such documents and the trial court overruled the objection. General Star petitioned the Third District Court of Appeals of Florida for certiorari to quash the discovery.

The appellate court granted the interlocutory petition finding that the trial court's order departed from the essential requirements of the law and would cause harm for which there would be no remedy on appeal. Discovery directed to an insurer's business policies or practices was seen as premature unless there had been a determination of liability and the extent of damages owed to the insured under the first-party insurance policy. Because there had not yet been such a determination, the Court quashed the discovery ordering production of materials concerning the insurer's business policies and practices.

The Third Circuit Finds Insurer had Reasonable Basis for Denial of Claim where Adjuster Reviewed Claim, Outside Counsel Provided Coverage Opinion, and Insurer Reconsidered Denial

Post v. St. Paul Travelers Ins. Co., Nos. 10-3088, 10-3300, 2012 WL 3095352 (3d Cir. July 31, 2012)

Third Circuit holds that an insurer may defeat a claim of bad faith by showing that it had a reasonable basis for its actions; mere negligence or aggressive protection of an insurer's interests is not bad faith. The insurer reasonably concluded that an exclusion barred coverage where, among other factors, its claims-adjuster reviewed the claim, outside counsel provided a coverage opinion, and the insurer reconsidered its denial.

In 2003, Benjamin Post and Tara Reid, employed at the time by Post & Schell, P.C., were retained to defend Mercy Hospital-Wilkes-Barre, Mercy Healthcare Partners, and Catholic Healthcare Partners (collectively, "Mercy") in a medical malpractice action. After trial began, plaintiffs introduced evidence suggesting that Post and Reid had engaged in misconduct during discovery. As a result, Mercy retained new counsel and entered into a settlement with the plaintiffs. Post & Schell was insured against claims of legal malpractice under a policy issued by St. Paul Travelers Insurance Company ("Travelers"), which also protected the firm's attorneys.

The plaintiffs in the medical malpractice litigation filed a petition for sanctions against, among others, Post and Reid for their handling of discovery and Mercy later intervened in the sanctions proceedings. Travelers determined that it owed no defense or indemnity obligation because Mercy's pleading in the sanctions proceeding did not allege a claim for "damages" as defined by the policy, which definition excluded civil sanctions. Travelers nonetheless offered to pay some of the defense costs associated with the sanctions proceedings that were related to the potential legal malpractice claims. Post, however, was not satisfied when Travelers offered to pay only $36,220.26 of the more than $400,000 in invoices submitted.

In summer 2007, Post agreed to mediate with Mercy regarding its malpractice claim. Post again demanded that Travelers assume all legal fees associated with the mediation. Travelers notified Post that it had no duty to represent him in the mediation or reimburse him for legal fees; however, it made a "courtesy" offer of $3,000 as a "good faith gesture."

Mediation was not successful and both parties filed suit against each other, however the parties later agreed to discontinue the actions against the other and no money was paid in consideration for the discontinuances.

In 2008, Post again sued Travelers in the Eastern District of Pennsylvania and Travelers moved for partial summary judgment on four of Post's claims, including the bad faith claim. Travelers argued that an insurer cannot be held liable for bad faith when its denial of coverage rests on a reasonable foundation and is fairly debatable. The District Court granted Travelers' motion for summary judgment as to the bad faith claim and Post appealed.

In order to prevail on his bad faith claim under Pennsylvania law, Post was required to show by clear and convincing evidence that Travelers (1) did not have a reasonable basis for denying benefits under the policy and (2) knew or recklessly disregarded its lack of such a reasonable basis. Travelers could thus defeat the bad faith claim by showing that it had a reasonable basis for its actions. Mere negligence or bad judgment would not constitute bad faith; instead, knowledge or reckless disregard of a lack of a basis for denial of coverage would be necessary. The Third Circuit noted that although an insurer has a duty to give the interests of its insured the same consideration that an insurer gives its own interests, it is not bound to submerge its own interests so that the insured's interests are paramount. Furthermore, an insurer does not act in bad faith by investigating and litigating legitimate issues of coverage. Even questionable conduct giving the appearance of bad faith is not sufficient to establish the claim as

long as the insurer has a reasonable basis for denial of coverage.

Post argued that Travelers engaged in bad faith conduct by, among other things, ignoring communications from the insured, violating its own policies and procedures, agreeing to pay for defense counsel for Post & Schell but not Post himself, and keeping information from coverage counsel as it made the coverage determination. The panel, however, found that the conduct complained of by Post was largely benign and did not import a dishonest purpose.

Post also argued that Travelers reflexively denied coverage by relying on the sanctions exclusion. However, the Third Circuit found that Travelers did not automatically deny coverage, as evidenced by: the claim-adjuster's review of Post's coverage claim; Travelers' retention of outside counsel to provide a coverage opinion; Travelers' reconsideration of its denial of coverage; the ongoing dialogue between the claim-adjuster, outside counsel and Post's attorney; and Travelers' negotiations with Post's attorney resulting in Travelers' offer to cover a portion of Post's defense expenses.

According To An Arizona Court, Bifurcation Of Breach of Contract And Bad Faith Claims Is Not Warranted Where Resolution of Contract Claim Would Not Necessarily Impact Outcome Of Bad Faith Claim

Bass v. Farm Bureau Financial Servs., No. CV-12-00393, 2012 WL 3585206 (D. Ariz. Aug. 20, 2012)

Federal District Court explains that only where resolution of one claim would be dispositive of entire case are bifurcation and stay appropriate.

In August 2010, Bass was driving a vehicle owned by his employer when another vehicle crossed the center line of the road and collided head-on with him. Bass suffered severe and extensive injuries, including dozens of facial fractures and rib fractures and a collapsed lung. Bass was left with significant scarring and physical impairments. Bass submitted a claim for insurance coverage to both the at-fault driver's insurer and Farm Bureau, his employer's insurer, for losses related to the accident. The at-fault driver's policy had a limit of $25,000 per person and $50,000 per accident, of which Bass received $20,000. The Farm Bureau policy included UIM coverage of $1,000,000. Bass demanded for the full UIM limit. Farm Bureau responded to Bass's demand by stating that it was not in a position to evaluate the claim due to evidence that Bass was not wearing a seatbelt at the time of the accident, a fact that would reduce the value of his claim by the amount of medical bills caused by the non-use of the seatbelt, and its need for more complete medical records. Rather than responding to the document request from Farm Bureau, Bass filed a breach of contract and bad faith suit that was subsequently dismissed for lack of service.

In October 2011, Bass provided medical records to Farm Bureau and reiterated his demand for the full policy limits. Bass argued that the seatbelt defense had no validity under the facts of the accident because his biometrics engineering expert, whose report Bass provided to Farm Bureau, had concluded that Bass would have sustained serious injuries even if he had been using his seatbelt given the severity of the crash and the fact that two of the three people in the at-fault vehicle died notwithstanding that they had been wearing seatbelts. Farm Bureau responded to Bass's letter, noting that its own expert had opined that Bass suffered injuries he would not otherwise have suffered had he been using his seatbelt. Farm Bureau further stated that it had determined that the undisputed value of Bass' UIM claim was $100,000. Farm Bureau ten-

dered that amount to Bass and Bass accepted it as partial payment. The parties then engaged in an unsuccessful private mediation after which Bass filed a complaint for breach of contract and bad faith.

Farm Bureau sought to bifurcate the case pursuant to Federal Rule of Civil Procedure 42(b), arguing that Bass's bad faith claim is premature until the breach of contract claim was resolved. Essentially, Farm Bureau argued that there would be no need for any litigation related to the bad faith claim if the jury, in resolving the breach of contract claim, valued Bass's damages at or below the $100,000 Farm Bureau had already tendered to Bass. Farm Bureau argued that it would be meaningless for Bass to argue that Farm Bureau's investigation was lacking if the jury decides that it had come to the right result. Bass opposed the bifurcation.

The trial court was not persuaded by Farm Bureau's arguments. While recognizing that bifurcation can be appropriate in the insurance contract when the resolution of a single claim or issue would be dispositive of the entire case, it found that Farm Bureau did not meet its burden of establishing that the resolution of the breach of contract claim in Farm Bureau's favor would automatically obviate the need for a resolution of the bad faith claim. Under Arizona law, one of the ways an insurer may commit bad faith is in processing or evaluating a claim in an unreasonable manner, such that an insurer's ultimate payment of the claim is not an absolute defense to a bad faith case. Based on the record before it, the court concluded that bifurcation would neither promote judicial economy nor avoid jury confusion and would unduly prejudice Bass because there was a facially significant overlap between the breach of contract claim and the bad faith claim inasmuch as both concerned, in part, Farm Bureau's alleged failure to make Bass a good faith offer and because Farm Bureau's "seatbelt defense" was relevant to both claims.

Montana Court Determines That Claim Preclusion Bars Plaintiff From Filing Common-Law Bad Faith Action After Dismissal Of Lawsuit Alleging Statutory Unfair Trade Practices Claim

***Brilz v. Metropolitan General Ins. Co.*, No. DA 11-0275, 2012 3578670 (Mont. Aug. 21, 2012)**

A Montana court dismissed a lawsuit based on the same allegations of inappropriate claims handling by insurer as contained in a lawsuit plaintiff filed earlier in federal court.

Candice Brilz was injured and suffered property damage in an automobile collision that occurred on August 14, 1998. Brilz alleged that the driver of the other vehicle, David Kidder, a Metropolitan insured, caused the accident. Kidder's policy included $25,000 in coverage for personal injury to one person. Brilz submitted a claim to Metropolitan seeking to recover under Kidder's policy. In 2001, Metropolitan offered to settle with Brilz, tendering the $25,000 policy limits. Brilz accepted the offer and settled her insurance claim, but alleged that the settlement offer was made only after she made numerous requests. A year after the claim was settled, Brilz filed a lawsuit in Montana state court against Metropolitan arguing that Metropolitan violated the Unfair Trade Practices Act ("UTPA"), acted "oppressively, maliciously and outrageously", and "acted to and did vex, injure and annoy" her. Metropolitan removed the case to the United States District Court for the District of Montana.

The parties filed cross-motions for summary judgment on the question of whether Brilz's claims were time barred. The court concluded that Brilz's UTPA claim was barred because the one-year statute of limitations had expired. Brilz argued that her complaint also set forth a separate common-law bad faith claim to which a three-year statute of limitations applied. The Court determined that Brilz had not alleged such a claim, reasoning that the complaint "contain[ed] no allegations that [Metropolitan] acted in 'bad faith,' breached its duty of good faith and fair dealing, or otherwise breached some duty 'independent of statute or of insurance contract."

After the termination of Brilz's federal lawsuit, Brilz commenced a second suit in Montana state court. Brilz did not seek to renew her statutory claim against Metropolitan; instead, she requested a declaration that she may pursue her common law bad faith claim.

The Montana court rejected Brilz's attempt. First, the court concluded that, pursuant to the determination by the federal court, Brilz failed to allege a common-law bad faith claim in her prior suit and thus the new filing was not within the statute of limitations. The court also found that Brilz was essentially lodging a "collateral attack" on the federal court's judgment. Applying the principles of claim preclusion, the court determined that Brilz's statutory and common-law bad faith claims arose from the same transaction and "common nucleus of operative facts," those being the manner in which Metropolitan adjusted Brilz's claim for insurance benefits. Consequently, Brilz could not turn to the state court system to overcome the federal district court's dismissal of her lawsuit.

Baltimore, MD
500 East Pratt St.
Charles O. Monk, II
410.332.8668

Boston, MA
131 Dartmouth St.
Richard D. Gass
617.723.3300

Chesterbrook, PA
1200 Liberty Ridge Dr.
Michael S. Burg
610.251.5750

Harrisburg, PA
2 North Second St.
Eric L. Brossman
717.257.7570

Newark, NJ
One Riverfront Plaza
Stephen B. Genzer
973.286.6712

New York, NY
555 Fifth Ave.,
Michael S. Gugig
212.980.7200

Philadelphia, PA
1500 Market St.
Bruce D. Armon
215.972.7985

Pittsburgh, PA
301 Grant Street
Jay L. Panzarella
412.209.2510
David R. Berk
412.209.2511

Princeton, NJ
750 College Rd. E
Marc A. Citron
609.452.3105

Washington, DC
1919 Pennsylvania Ave, NW
Mark L. Gruhin
202.342.3444
Edward R. Levin
202.342.3420

Wilmington, DE
222 Delaware Ave.
Wendie C. Stabler
302.421.6865
William E. Manning
302.421.6868