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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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Southern District Of Ohio: Insurer Does Not Commit Bad Faith By Voiding Policy Due To Insured's Failure To Promptly And Fully Cooperate With Insurer's Fire Investigation

Joseph v. State Farm Fire and Casualty Company, No. 2:11-cv-794, 2013 WL 663623 (S.D. Ohio Feb. 22, 2013)

Southern District of Ohio holds that an insurer properly may void a policy and deny insurance coverage when an insured delays and fails to fully cooperate with an insurer's thorough fire investigation, despite the insured's partial cooperation and promise for additional cooperation in the future.

On August 18, 2010, a fire destroyed the residence of plaintiff Namon Joseph ("Joseph"). Defendant State Farm Fire and Casualty Company ("State Farm") provided Joseph with homeowner's insurance at the time of the fire. State Farm's investigation quickly revealed evidence that the fire was started by an accelerant, and therefore likely was an act of arson.

State Farm's investigation led to a further suspicion that Joseph may have started the fire. State Farm formed its belief based on the fact that Joseph stayed at a local hotel on the night of the fire and because Joseph made several misrepresentations on his policy application.

To determine if Joseph had a motive to start the fire, State Farm sought Joseph's cooperation by requesting that he provide information and documents concerning his personal and business financial situations. State Farm's investigation revealed that Joseph owed the IRS nearly $400,000 in back taxes and that Joseph was a restaurant owner who was in the process of building a second restaurant.

State Farm's investigation of the fire was immediate and continuous. State Farm spoke with Joseph within a week of the fire. Upon learning of Joseph's misstatements in his policy application, on September 20, 2010, State Farm requested that Joseph produce financial and cell phone records. On October 14, 2010, Joseph produced certain bank statements, credit card statements and phone records. Not satisfied with Joseph's initial production and in search of additional financial records, in November 2010 State Farm

retained counsel to assist in obtaining additional records from Joseph.

On December 10, 2010, State Farm orally examined Joseph under oath. State Farm followed-up the examination with additional document requests on December 30, 2010. On January 21, 2011, State Farm advised Joseph that it had retained a forensic accountant, and that the forensic accountant wanted to review Joseph's records on January 31, 2011 in their original form. On February 2, 2011, after refusing to produce the records on January 31, 2011, Joseph's attorney objected to State Farm's requests as unreasonable.

State Farm sent correspondence to Joseph's counsel four times in February 2011. The correspondence included continued demands for the production of financial records and at least one letter advising Joseph that his failure to cooperate could result in denial of insurance coverage. State Farm's counsel spoke with Joseph's attorney at least twice in February 2011 regarding State Farm's requirement for Joseph to produce financial records.

On March 2, and March 7, 2011, State Farm sent two additional letters to Joseph regarding Joseph's failure to produce documents. Joseph responded by taking the position that a review of his records could not occur until May 2, 2011. On March 16, 2011, State Farm rejected Joseph's proposal for a May 2, 2011 document inspection.

On June 7, 2011, State Farm voided Joseph's policy. Joseph took no affirmative steps to produce financial records after State Farm's March 16, 2011 rejection of his proposal for a May 2, 2011 document production.

Ruling on State Farm's motion for summary judgment, the Court found in State Farm's favor. The Court found that Joseph's failure to provide the requested documents was a violation of the policy's cooperation clause, and that Joseph therefore failed to satisfy a condition precedent of the policy. Despite the relatively short time period that Joseph failed to cooperate after providing some financial documents in October 2010, and despite the fact that Joseph produced himself for an examination in December 2010 and offered to make additional financial records available in May 2011, the Court nonetheless held that State Farm could properly void the policy in good faith. The Court stated that there was no "authority which would require State Farm to keep its investigation open indefinitely in the hopes that [Joseph] would eventually cooperate."

Pennsylvania Court Makes Clear That Pre-Contract Conduct Cannot Form The Basis Of A Bad Faith Claim

***Grudkowski v. Foremost Ins. Co.*, No. 3:CV-12-1827, 2013 WL 816666 (M.D. Pa. Mar. 5, 2013)**

The Middle District of Pennsylvania dismissed a bad faith claim premised on allegations of pre-contract formation bad faith holding that only allegations related to an insurer's performance of its contractual obligations of defense and indemnification or payment of loss will suffice.

Beginning in January 2007, Foremost Ins. Co. ("Foremost") issued a Modified Auto Collectors Program Auto Policy Classic ("Classic Policy") to Arlene Grudkowski ("Grudkowski") providing coverage for a 1991 BMW 318i. The Classic Policy provided $300,000 in combined single limit stacked uninsured motorist coverage and $300,000 in combined single limit stacked underinsured motorist coverage. Foremost, beginning in April 2007, also issued an Antique and Classic Auto Policy (the "Antique Policy") to Grudkowski providing coverage for a 1972 Mercedes 280 SEL. The Antique Policy provided $300,000 in combined single limit stacked uninsured motorist coverage and $300,000 in combined single limit stacked underinsured motorist coverage.

Grudkowski filed a lawsuit on behalf of herself and a class of similarly situated individuals alleging that although Foremost purports to provide stacked uninsured and underinsured motorist coverages, in actuality the policies only provide unstacked coverages. Grudkowski claimed that Foremost therefore breached the terms of the insurance contracts, vio-

lated Pennsylvania's Unfair Trade Practices and Consumer Protection Law, was unjustly enriched, and violated Pennsylvania's bad faith statute.

Foremost filed a motion to dismiss the complaint. With respect to the bad faith claim, Foremost argued that the Pennsylvania bad faith statute applies only to those actions an insurer takes in performance of its contractual obligations of defense and indemnification. As Grudkowski's claim was not premised on such conduct by Foremost, Foremost argued that the bad faith claim failed as a matter of law. In opposition, Grudkowski argued that all forms of insurance bad faith fall within the purview of the statute and that conduct does not morph into actionable bad faith only upon denial of a claim. Grudkowski argued that "as long as the claim arises under an insurance policy, Plaintiff can maintain a claim under [the bad faith statute]." Grudkowski specifically asserted that misrepresenting coverage in an insurance policy may constitute bad faith.

The court determined that, at its core, Grudkowski's bad faith claim rested on the allegation that Foremost intentionally issued a policy containing unlawful or inherently contradictory provisions. Grudkowski's claim was thus based on an allegation that Foremost engaged in pre-contract formation bad faith unrelated to Foremost's performance of its contractual obligations of defense and indemnification. According to the court, this type of allegation has not been recognized as a basis for a bad faith claim in Pennsylvania.

Eighth Circuit: Insurer Awarded Summary Judgment on Claims of Bad Faith Refusal to Settle Where Sole Member of A Company Was Also An Employee for Purposes of Applying Exclusion

Gear Automotive v. Acceptance Indemnity Ins. Co., No.12-2446, 2013 WL 1092290 (8th Cir. Mar. 18, 2013)

The Eighth Circuit granted an insurer's motion for summary judgment on claims of bad faith refusal to settle where a "member" of a limited liability company may also be an "employee" for purposes of applying an exclusion precluding coverage for injuries to "employees" arising out of their employment.

Robert Gear was the sole owner and member of Gear Automotive, L.L.C., ("Gear Automotive") an automobile dealership. Gear Automotive had a commercial general liability insurance policy issued by Wilshire Insurance Company ("Wilshire").

On October 25, 2008, Gear Automotive was vandalized and items were stolen from the dealership. Fearing that the thieves would return, Mr. Gear hired Joe Posner to assist in monitoring the property. Mr. Gear later entered the premises and was accidentally shot by Mr. Posner. Mr. Gear made a demand to Wilshire for personal injury damages and sought the policy's liability limits. Wilshire denied his claim and on April 23, 2010, Mr. Gear filed suit against Gear Automotive in Missouri state court. In December 2010, the state court entered judgment against Gear Automotive, reflecting a settlement between Mr. Gear and Gear Automotive for $350,000. In the judgment, the parties stipulated that Mr. Gear was not an employee of Gear Automotive.

On March 11, 2011, Gear Automotive filed suit against Wilshire, alleging bad faith refusal to settle, breach of contract and vexatious refusal to settle. The parties filed competing motions for summary judgment. Wilshire argued that Mr. Gear was an "employee" of Gear Automotive and suffered a "bodily injury" in the course of his employment. The policy excluded coverage for "bodily injury" to an "employee" of the insured arising out of and in the course of employment by the insured or performing duties related to the conduct of the insured's business. Wilshire also argued that because both Mr. Gear and Mr. Posner were employees of Gear Automotive that the "Fellow Employee" exclusion precluded coverage for the injuries that Mr. Posner caused Mr. Gear during the course of their employment. Despite Wilshire's arguments, the District

Court ordered the parties to brief the applicability of the Workers' Compensation exclusion, which excluded coverage for any obligation for which the insured may be held liable under Workers' Compensation or any similar law. The District Court concluded that the Workers' Compensation exclusion applied and granted Wilshire's motion for summary judgment. Gear Automotive appealed.

The Eighth Circuit declined to address the applicability of the Workers' Compensation exclusion, and instead focused on Wilshire's original argument that Mr. Gear's status as an employee precluded coverage. Gear Automotive argued that the employee exclusion did not apply to Mr. Gear because he was a "member" of Gear Automotive and the employee exclusion only applied to an "employee." The panel found that a "member" of a limited liability company was not mutually exclusive with an employee of the same company. Instead, the Court noted that Mr. Gear had multiple roles in the company and evaluated the "level of his actual participation in the business" to determine whether he was an employee. The panel concluded that Mr. Gear was an employee and that his injury arose out of his employment. Accordingly, the Eighth Circuit affirmed the District Court's grant of summary judgment in favor of Wilshire.

New York Appellate Court: Punitive Damages Against Insured Are Not Recoverable From Insurer

Seldon v. Allstate Ins. Co., 2013 N.Y. Slip Op. 01628, 2013 WL 978689 (N.Y. App. Div. Mar. 14, 2013)

In New York, public policy prohibits an insured from recovering punitive damages portion of judgment from insurer even when they were the result of the insurer's refusal to settle the underlying case.

Philip Seldon ("Seldon") brought suit against insurers Allstate Insurance Company and Allstate Insurance Co. (together, "Allstate") for, among other things, bad faith failure to settle libel and slander claims that were brought against him. Seldon alleged that Allstate had failed to settle the underlying claims within the policy limits, which resulted in a judgment against him for punitive damages. The trial court denied Allstate's motion for summary judgment.

On appeal, Allstate raised for the first time the argument that it was entitled to summary judgment based on public policy precluding an insured from recovering the punitive damages portion of a judgment from an insurer, even when such judgment may have resulted from the insurer's alleged bad faith failure to settle. Noting that purely legal arguments like this one may be considered for the first time on appeal, the appellate panel agreed with Allstate's position and reversed the trial court's denial of Allstate's motion for summary judgment.

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Details are available at **http://www.dri.org/Event/20130045**.

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