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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: Insureds' Negligence And Unfair Trade Practices Claims Against Adjusters Are Colorable Under Pennsylvania Law

Kennedy v. Allstate, No. 15-2221 (E.D. Pa. July 8, 2015).

District Court recognizes possibility that insurance adjusters owe a duty of care to insureds that would be breached by failing to conduct a reasonable investigation and by making misrepresentations about the insureds' claim.

After Rachel Kennedy was injured in a car accident, she and her husband submitted underinsured motorist claims to their insurer, Allstate Property and Casualty Insurance Company. The underinsured motorist claims were arbitrated in 2013, resulting in a $625,000 award. The Kennedys subsequently sued Allstate and three adjusters employed by Allstate in Pennsylvania state court. The Kennedys alleged that Allstate and the adjusters improperly evaluated their claims and engaged in intentional delay, misrepresentation and fraud in the course of processing, investigating and arbitrating those claims.

Allstate and the adjusters filed a notice of removal claiming that the Kennedys had fraudulently joined the adjusters as defendants in order to defeat federal diversity jurisdiction. Allstate and the adjusters argued that the Kennedys had no colorable claim of negligence or for violation of the Pennsylvania Unfair Trade Practices and Consumer Protection Law ("UTPCPL") against the adjusters. In response to the notice, the Kennedys filed a motion to remand.

In opposing the motion, Allstate and the adjusters first argued that insureds have no colorable cause of action for negligence against an insurance adjuster under Pennsylvania law because adjusters owe no duty of care to insureds. The court found that Pennsylvania law is silent on the issue and thus concluded that there is at least a possibility that the Pennsylvania Supreme Court could decide that an insurance adjuster owes a duty of care to an insured. Absent Pennsylvania law expressly precluding the negligence claim, the court could not find that the Kennedys' claim was "wholly insubstantial or frivolous" and held that the Kennedys stated at least a colorable claim for negligence.

Allstate and the adjusters also contended that the Kennedys did not state a colorable claim under the UTPCPL. Their argument was premised on four grounds: (1) the claims are not cognizable against insurance adjusters under Pennsylvania law; (2) the Kennedys failed to allege facts showing that they justifiably relied on the adjuster defendants' misrepresentations; (3) the Kennedys did not sufficiently plead ascertainable loss; and (4) the Kennedys' claims were barred by the economic loss doctrine. The Court readily dismissed Allstate's first argument, finding that multiple courts have concluded that claims under the UTPCPL against adjusters are colorable under Pennsylvania law. Next, the court explained that in disposing of a motion to remand, the court could not properly inquire into the sufficiency of the pleadings on the element of justifiable reliance. The court also dismissed the contention that the Kennedys failed to sufficiently plead ascertainable loss by pointing to the alleged harm to the Kennedys' credit rating, their need to seek medical assistance from the state, and the alleged financial hardship that resulted from the adjusters' conduct. Finally, the Court noted that the application of the economic loss doctrine to UTPCPL claims is in flux in Pennsylvania and, "in [c]onstruing the uncertain state law in favor of plaintiffs as [it was] obliged to do," held that Allstate failed to meet its burden to show that plaintiffs have no colorable claim under the UTPCPL against adjuster defendants.

Court of Appeals of Wisconsin: Insured Must Be "Made Whole" For Total Loss Before Insurer Can Recover Subrogated Funds

Dufour v. Progressive Classic Ins. Co., No. 2014AP157, 2015 WL 4275292 (Wis. Ct. App. July 16, 2015).

The Court of Appeals of Wisconsin reverses the Circuit Court for Dodge County and remands for proceedings on damages for insured's bad faith claim, finding that there was no reasonable basis for insurer's denial of insured's claim to subrogated property funds where the insured had not yet been made whole for his total loss resulting from a motorcycle accident.

Dennis Dufour ("Dufour") was involved in a motorcycle accident caused by another driver. Both Dufour's insurer, Dairyland Insurance Company, and the other driver's insurer, American Standard Insurance Company, paid Dufour their respective policy limits for bodily injuries of $100,000. In addition to the bodily injury payment, Dairyland also paid Dufour an additional $15,589 for his property damage. Dufour's bodily injuries exceeded the amount of insurance proceeds that he received from both insurers.

Under a subrogation clause in its policy, Dairyland received the property damage funds in subrogation from American Standard. Dufour submitted a claim to Dairyland and argued that he was entitled to the subrogated funds under the "made whole" doctrine. When Dairyland refused to turn over the subrogated funds to Dufour, Dufour sued Dairyland for breach of contract and bad faith in the Circuit Court for Dodge County. Dufour and Dairyland filed cross-motions for summary judgment. The court found in Dufour's favor on the breach of contract claim and awarded him the subrogated funds plus interest. The court found in Dairyland's favor on Dufour's bad faith and punitive damages claims, dismissing those counts.

Both parties appealed the circuit court's decision. On appeal, the Court of Appeals of Wisconsin affirmed the circuit court's award of the subrogated funds to Dufour; however, the appellate court reversed the circuit court's bad faith ruling and remanded for further proceedings on damages. The Court of Appeals reasoned that under the "made whole" doctrine, an insurer has no rights in subrogation if the insured is unable to fully recover his or her loss. The court explained that when determining whether the insured had been fully compensated, it looked at the insured's "total loss," which, in Dufour's case, included both his property damage and bodily injury claims. The fact that Dairyland, not Dufour, possessed the cause of action against American Standard for the subrogated funds did

not impact the court's analysis of whether Dufour was entitled to the additional funds. Because Dufour had not been made whole for his total loss, Dairyland had no subrogation rights as a matter of Wisconsin law and Dufour was entitled to the subrogated property damage funds Dairyland collected from American Standard.

The Court of Appeals further held that Dufour was entitled to summary judgment on his bad faith claim. The court reasoned that prior Wisconsin case law clearly established that Dufour was entitled to the subrogated funds under the "made whole" doctrine. Dairyland argued that while it was aware of this prior case law, it "reasonably" believed that Dufour's claim was distinguishable from other "made whole" cases. The court rejected this argument outright, explaining that Dairyland's disagreement with controlling case law did not make its position fairly debatable and that Dairyland's attempts to distinguish prior cases lacked merit. Because no reasonable insurer would have denied Dufour's claim for the subrogated funds, the Court of Appeals entered summary judgment in Dufour's favor on his bad faith claim. The Court of Appeals remanded the case to the circuit court, with instructions to conduct proceedings of Dufour's damages, including punitive damages, with regard to the bad faith claim.

Southern District of Ohio: No Coverage Equals No Bad Faith

Schmidt v. The Travelers Indem. Co. of Am., No. 1:13-CV-932, 2015 WL 4538118 (S.D. Ohio July 27, 2015).

A law firm that lost more than $141,000 in an online scam lost its coverage dispute with its insurer but still tried to pursue a bad faith claim. The court held that where an insurer was legally entitled to deny coverage, that denial could not have been in bad faith.

The U.S. District Court for the Southern District of Ohio held that where it had previously ruled an insurance policy provided no coverage, and the insurer had denied coverage on that basis, the insurer was entitled to summary judgment on the insured's bad faith claim.

The case involved a law firm that fell victim to an online scam. In February 2012, Michael Schmidt of Cohen, Todd, Kite & Stanford LLC ("CTKS") received an email from a person named Erik Carpenter, who supposedly lived in Japan and was seeking representation on a collection matter. Schmidt and CTKS accepted the representation in exchange for a 25 percent contingent fee and drafted a demand letter to the supposed debtor, North American Iron and Steel Company ("North American"). Later that month, a person responded by email purportedly on behalf of North American and offered to meet Schmidt's demands and pay the money to Carpenter.

An arrangement was agreed to whereby North American would pay CTKS the settlement amount in two cashier's checks, CTKS would deduct its fees, and then CTKS would wire the remaining amount to Carpenter. However, after CTKS received the first check for $189,000, deposited the funds in its trust account, and wired $141,750 to Carpenter, it discovered that the check from North American was a fraud. CTKS never received any payment, and thus lost $141,750 in the scheme. At the time, CTKS had a Business Personal Policy with The Travelers Indemnity Company of America ("Travelers"). After CTKS timely submitted a claim, Travelers denied coverage in April 2012, citing several provisions and exclusions in the policy. CTKS then brought a claim for breach of contract, declaratory judgment, and bad faith refusal of coverage.

The parties cross-moved for summary judgment on the breach of contract and declaratory judgment claims. In March 2015, the court granted summary judgment for Travelers on those counts, concluding that the policy did not provide coverage for the losses associated with the fraudulent scheme and that it would have been barred by an exclusion in any event.

CTKS then sought a final order on those claims so that it could appeal the court's coverage determination. In response, Travelers moved for summary judgment on the bad faith claim.

The court noted that, under Ohio law, where an insurer was legally justified in denying a claim, it cannot be bad faith to have done so. In other words, as long as the denial of coverage was legally correct, "it cannot be found that the insurer's denial of benefits was arbitrary or capricious, or that a reasonable justification for the denial did not exist." Because the court had already found that CTKS was not legally entitled to coverage under the terms of the policy, it thus ruled that Travelers could not have acted in bad faith in denying the claim and granted summary judgment for Travelers.

CTKS also sought additional discovery under Rule 56(d) concerning the adequacy of Travelers' investigation. However, the court stated that such a claim was baseless where the insurer denied coverage based on the policy and any additional investigation would not have affected its conclusion.

District of Colorado Grants Summary Judgment for Insurer on Bad Faith Claim Arising from Denial of Coverage Under E & O Policy

P&S LLC v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. 14-cv-00735-LTB-CBS (D. Colo. July 29, 2015).

District of Colorado grants summary judgment for insurer on bad faith claim where insurer established that an Executive & Organization Liability Insurance Policy's Specific Entity Exclusion barred coverage for losses in connection with claims against an entity excluded from coverage.

P&S LLC entered into a membership agreement with Private Escapes Platinum LLC for membership in its luxury destination travel club. Thereafter, Private Escapes merged with another company, Ultimate Resorts LLC, to create a new entity called Ultimate Escapes Holdings, LLC. P&S asserted that Mr. Richard Keith, the CEO of Private Escapes, who later became co-CEO of Ultimate Escapes, induced P&S to enter into the membership agreement by representing that P&S's benefits under the membership agreement would be protected or grandfathered after the merger. The terms of the membership agreement were not honored after the merger. After an earlier dispute with Private Escapes and Ultimate Escapes, which was administratively closed after Ultimate Escapes' filing for Chapter 11 bankruptcy protection, P&S filed suit against Private Escapes and Mr. Keith.

Mr. Keith sought defense coverage from National Union Fire Insurance Company of Pittsburgh, PA under the Executive & Organization Liability Insurance Policy issued to Ultimate Escapes. National Union declined to provide Mr. Keith with a defense and denied coverage based on the Policy's Specific Entity Exclusion, which provided that National Union "shall not be liable for any Loss in connection with any Claim made against ... [Private Escapes] ... and/or any Executive or Employee thereof..." P&S settled the lawsuit with Private Escapes and Mr. Keith. As part of the settlement, Mr. Keith assigned to P&S his rights against National Union under the Policy. P&S, as Mr. Keith's assignee, then filed suit against National Union for denying coverage to Mr. Keith and asserted claims against National Union for breach of contract, bad faith, and other related claims. National Union sought summary judgment in its favor on all of P&S's claims against it.

The case was decided under Colorado's general standards of insurance contract interpretation. The court explained that "[t]he insured has the burden to show that a claim is covered by the policy. Once met, the burden shifts to the insurer to show that a covered claim falls solely and entirely within a policy exclusion" (citation omitted). "[T]o benefit from an exclusionary provision in a particular contract of insurance the insurer must establish that the exemption claimed applies in the particular case, and that the exclusions are not subject to any other reasonable interpretation" (citations and quotations omitted).

The Specific Entity Exclusion in the Policy indicated that National Union is not "liable for *any Loss* ***in connection with*** *any* Claim made against ... [Private Escapes] ... and/or any Executive or Employee thereof" (emphasis in Opinion). The exclusion required only that "a loss is made 'in connection' with a claim against Private Escapes for it to be excluded from coverage." The underlying lawsuit was brought against Private Escapes and Mr. Keith in his capacity as an executive of Private Escapes. The court explained that "[t]o the extent that the factual assertions within the complaint include an allegation that Mr. Keith wrongfully acted in the underlying situation as an Ultimate Escapes' executive, it does not change the fact that the loss alleged was in connection with a claim against Private Escapes. As such, it is unambiguously applicable to bar coverage for the loss claimed here."

Turning to the bad faith claims asserted against National Union, the court ruled that because it had "ruled that the plain language of the Specific Entity Exclusion bars coverage for Mr. Keith in the underlying lawsuit, I likewise conclude that P&S's claims seeking relief under common law and statutory bad faith are likewise foreclosed as a matter of law." The court granted National Union's motion for summary judgment, entered judgment in National Union's favor, and dismissed the case.

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