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Insurance Practice

The Bad Faith Sentinel

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

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Court of Appeals of Michigan: Trial Court's Incorrect Instruction on the Definition of Bad Faith Did Not Require Reversal

Tibble v. Am. Physicians Capital, Inc., No. 306944, 2014 WL 5462573 (Mich. Ct. App. Oct. 28, 2014).

The Michigan Court of Appeals holds that although the trial court erred when it defined "bad faith" for the jury, the court's error did not require reversal because the applicable law regarding bad faith was adequately presented.

American Physicians Capital, Inc. ("AP Capital") provided medical malpractice insurance coverage to emergency room physician Robert Prodinger, a member of Battle Creek Emergency Physicians, P.C. ("BCEP"). The AP Capital policy had a policy limit of $300,000. Following the death of Daniel Symons, a patient treated under Prodinger's supervision, the Symons Estate brought a wrongful death action against Prodinger and BCEP. AP Capital provided a defense to both defendants. The case went to trial and the jury rendered a verdict of $1.3 million in favor of the Symons Estate. Shortly after the trial concluded, both Prodinger and BCEP filed for bankruptcy.

Following the verdict in the wrongful death action, the bankruptcy trustees for Prodinger and BCEP sued AP Capital for bad faith for failing to settle with the Symons Estate prior to trial and sought to recover the amount of the excess judgment. The Symons Estate had initially proffered a $1.2 million settlement demand, but later agreed to settle for $295,000. Throughout the course of discovery in the underlying action, Prodinger had maintained that there had been no violation of the standard of care and repeatedly expressed a desire to go to trial. Prior to trial, however, Prodinger and BCEP wrote a letter to defense counsel that authorized AP Capital to settle the case within policy limits. Neither defense counsel nor the senior claims representative from AP Capital viewed this letter as a "demand" to settle. Prodinger and BCEP argued that AP Capital essentially "rolled the dice" at trial because it knew that even though a jury verdict would likely exceed $1 million, its policy limits were $300,000. The jury in the bad faith action found that AP Capital had acted in bad faith in failing to negotiate a settlement after the Symons Estate made a demand within policy limits.

AP Capital appealed to the Court of Appeals of Michigan challenging the trial court's jury instruction on bad faith and the calculation of bad faith damages. First, AP Capital argued that the trial court erred by failing to include

the words "arbitrary" and "intentional" in the definition of bad faith it provided to the jury. The Court of Appeals noted that the Michigan Supreme Court had previously defined "bad faith" for jury instruction purposes as "arbitrary, reckless, indifferent, or intentional disregard of the interests of the person owed a duty." Accordingly, the trial court indeed erred when it denied AP Capital's request to include the words "arbitrary" and "intentional" in the definition of bad faith. However, the Court of Appeals' review of the trial court's other instructions, as well as the expert testimony offered at trial, led the Court to conclude that the trial court's error did not require reversal. Rather, because the jury was not led to believe that bad faith equates to mere negligence, the Court of Appeals reasoned that the applicable law was adequately and fairly presented to the jury.

AP Capital next appealed the trial court's calculation of bad faith damages. AP Capital argued that, because Prodinger and BCEP's obligation to pay the Symons Estate's judgment was eliminated in the Chapter 7 bankruptcies, Prodinger and BCEP were not damaged by AP Capital's failure to settle the case. The Court of Appeals agreed with AP Capital in part, reasoning that if a debtor has been discharged from an excess judgment and no assets from the debtor were used to pay part of the excess judgment, the debtor has not suffered damages. However, the Court rejected the adoption of a bright-line rule barring the recovery of excess judgment damages by every insured that files for bankruptcy. Instead, the Court of Appeals concluded that the proper measure of damages in a bad faith action where the insured files for bankruptcy is an amount equal to the debtor's assets that are collected by the trustee of the bankruptcy estate. Because the debt of a corporation survives bankruptcy, the Court further reasoned that in bad faith actions where the insured is a corporation that has filed for bankruptcy, an order in favor of the insured should include provisions stating that: 1) the insurer is liable for the amount of the corporation's assets that were collected by the bankruptcy trustee; and 2) the insurer remains subject to liability for the remaining amount of the excess judgment, and should the corporation ever resume operations and acquire assets, the insurer must pay an amount toward the excess judgment equal to the corporation's assets.

District of Colorado: Insureds Have No Obligation to Hire Public Adjusters to Recover Amounts Due Under a Policy

Norman v. State Farm Fire & Cas. Co., No. 13-CV-01643-PAB-CBS, 2014 WL 6478046 (D. Colo. Nov. 19, 2014).

District of Colorado holds that insured has no duty to hire own adjuster in order to receive payment, and denies insurer's motion for summary judgment on bad faith claims even where coverage claim was arguably "debatable" and insureds may have caused delay.

In June and July of 2012, the Waldo Canyon Fire caused extensive property damage in Colorado. On June 23, 2012, Plaintiffs J. Bruce and Diane Norman were directed to evacuate their Colorado Springs home. The Normans returned on July 5, 2012 and reported heavy smoke damage and some melting to their insurer, State Farm. Five days later, State Farm inspected the Norman's home, finding light smoke damage and a smoke smell in the house, along with limited fire damage. State Farm issued the Normans an advance of approximately $87,000 for cleaning costs.

After various additional fire-related issues with the home came to light, the Normans retained public adjuster Troy Payne of Loss Analytics (the "public adjuster"), who in turn retained industrial hygienist SJR Environmental Consulting ("SJR"). SJR inspected and tested the Normans' home, issued a report that found ash and char present throughout the house and soot residue present inside the furnace and air ducts, and recommended cleaning throughout the home. Upon receipt of SJR's invoice, State Farm contacted Mrs. Norman, who said that she would be meeting with the public adjuster in the near future to

review the scope of repairs the Normans wished to pursue. State Farm left the Normans' claim open and asked Mrs. Norman to "submit any pending concerns for review."

On February 20, 2013, Loss Analytics provided State Farm with a proof of loss estimate of $809,949.23. After repeated requests from State Farm regarding information on the scope of repairs, on March 22, 2013, State Farm received from Loss Analytics a disc that included the complete itemized estimate of damages. On March 27, 2013, State Farm informed Mr. Payne that State Farm was retaining its own engineer and industrial hygienist to inspect the Normans' home. The next month, Engineering Systems Inc. ("ESI"), an engineering firm hired by State Farm, and Forensic Analytical Consulting Services ("FACS"), an industrial hygienist firm hired by State Farm, conducted an inspection of the Normans' home. On April 26, 2013, ESI issued its report. Noting some damage, FACS' report recommended cleaning/restoration of areas with visible smoke impact and cleaning of surfaces with " 'uncommon' prevalence of combustion products," which included furnishings/contents/fixtures, flooring/baseboards/door thresholds, windows, the attic, and the exterior.

On May 9, 2013, State Farm reviewed the ESI and FACS reports. On May 16, 2013, State Farm contacted Mr. Payne requesting information regarding completed repairs at the Normans' home, and in turn met with the Normans and Mr. Payne to discuss the Normans' claim. On May 29, 2013, State Farm contacted Mrs. Norman and confirmed that it was completing its estimate of repairs for known items, but would keep the claim open for any unknown items. State Farm also requested copies of receipts referred to in the proof of loss. On May 31, 2013, State Farm informed the Normans that it declined to accept the entire proof of loss, but sent the Normans $85,574.43 (the "May 2013 payment") as compensation for "covered damages as outlined in the enclosed building estimate and contents inventory."

The Normans filed a claim alleging, among other counts, breach of the implied covenant of good faith and fair dealing and violation of Colo. Rev. Stat. § 10–3–1115 and § 10–3–1116. State Farm moved for summary judgment with respect to the both Normans' common law bad faith claim and their statutory claim.

Under Colorado common law, a "special duty is imposed upon an insurer to deal in good faith with an insured." To show bad faith in a first-party claim, like this one, the insured must prove (1) that the insurer acted "unreasonably under the circumstances" and (2) that "the insurer either knowingly or recklessly disregarded the validity of the insured's claim." Under common law bad faith principles, Colorado courts traditionally find that it is reasonable for an insurer to challenge claims that are "fairly debatable." However, "fair debatability is not a threshold inquiry that is outcome determinative as a matter of law, nor is it both the beginning and the end of the analysis in a bad faith case."

An insurer's claims handling decisions "must be evaluated based on the information before the insurer at the time of that decision," and is ordinarily a question of fact for the jury. In Colorado, the Unfair Claims Settlement Practices Act ("UCSPA"), Colo. Rev. Stat. § 10–3–1104(1)(h) is designed to regulate the conduct of the insurance industry and, while it does not establish a standard of care or actionable tort, it may be used as valid, but not conclusive, evidence of industry standards.

The Normans claimed that State Farm's conduct was unreasonable in two relevant respects. First, the Normans claim that State Farm "denied and/or delayed investigating and paying the full damages that were present at the inception of the claim in July 2012. The second aspect of the Normans' common law bad faith claim was State Farm's refusal to pay SJR's invoice for its inspection and testing of the Normans' home.

State Farm argued that it reasonably evaluated the Normans' claim, timely making the first payment and, upon receipt of further information from the Normans, timely made additional inspections and payments. The insurer argued that any delay in making the May 2013 payment was attributable to the actions of the Normans and their public adjuster. The Normans responded that, regardless of whether a public adjuster intervened, State Farm was obligated to conduct a reasonable inspection and prepare a fair and accurate estimate, but failed to do so.

The court rejected any argument that an insured must retain its own adjuster in order to secure the complete payment of a claim. Because an insured is not required to retain its own adjuster, a reasonable juror could also conclude that it is unreasonable for an insurer to compel an insured to hire an adjuster to recover amounts due under a policy by offering less than what is ultimately recovered. Further, the court found that

there was evidence that State Farm's additional inspections should not or could not have been conducted earlier in the claims handling process. Because the Normans' home was in substantially the same condition in July 2012 as it was in April 2013, engineering and industrial hygienist inspections conducted earlier in the claims handling process would have revealed the same information upon which State Farm based its May 2013 payment, which in turn could have led to an earlier payment of the additional $85,574.43. Moreover, the court found that there was an issue of material fact vis-à-vis State Farm's argument that the Normans failed to timely provide to State Farm documents it requested or a scope of repairs. Further, the court found that a reasonable juror could find that State Farm's failure to conduct a reasonable investigation caused the Normans to incur the expense of retaining SJR and, as a result, that State Farm's decision not to pay the SJR invoice was made in bad faith.

With respect to whether State Farm knowingly or recklessly disregarded the validity of the Normans' claim, the court found that, among other evidence, as early as December 17, 2012, State Farm knew that SJR also recommended extensive rehabilitation and cleaning of the home. As such, the court found that there was sufficient evidence for a reasonable juror to find that State Farm was aware of or recklessly disregarded the possibility that the Normans' claim was not entirely satisfied by the July/August 2012 payment.

Moving to the Normans' statutory claim, the court noted that the burden of proof is "less onerous" on plaintiffs compared to the common law claim. Because the statutory claim appeared to be based on the same aspects of State Farm's conduct that were held to constitute a plausible claim for common law bad faith, the court rejected State Farm's motion as to the statutory claim as well.

Finally, the court rejected State Farm's argument that an expert would be required to determine the reasonableness of an insurer's conduct. The failure to reasonably investigate the full extent of the damage to the Normans' home was held to be within the common understanding of an ordinary juror. Further, the Colorado UCSPA would serve to provide relevant guidance concerning the industry standards applicable to the dispute.

Eastern District of Pennsylvania: Bad Faith Claim Rejected Where Insurer Requested Examination of Claimant, Made Settlement Offer Below Policy Limits, and Paid Award One Day After Appeal Period Expired

***Stanford v. National Grange Ins. Co.*, Civil Action No. 11-7144 (E.D. Pa. Nov. 3, 2014).**

Eastern District of Pennsylvania grants insurer's motion for summary judgment on bad faith claim in dispute over payment of proceeds under a claim for uninsured motorist benefits.

Roger Stanford filed suit alleging bad faith and breach of contract arising from Defendant National Grange Mutual Insurance Company's ("NGM") alleged delay in paying to Stanford "the proceeds of a successful prosecution of a claim for uninsured motorist benefits" in connection with an injury Stanford suffered in an automobile accident. The court granted summary judgment for NGM on both counts. Stanford's policy provided uninsured and underinsured motorist coverages up to $25,000 per person or $50,000 per accident, stacked for two vehicles.

To make a claim under the policy, Stanford was required to submit to examination under oath and medical examinations "as often as [NGM] reasonably require[d]." Stanford failed to undergo an examination under oath for five years, and when he did finally submit to examination, he "refused to answer questions that were necessary and material to NGM's adjustment of [Stanford's] claim." Stanford never submitted to a medical examination despite numerous requests to do so.

The policy provided for arbitration of disputes. Prior to arbitration, NGM offered Stanford $10,000 to settle his claim, but Stanford rejected the offer. Thereafter, the arbitrators found in Stanford's favor and awarded him $50,000. NGM delivered a check for $50,000 and included with it a draft release and settlement agreement that released NGM "from all uninsured/underinsured motorist coverage benefits claims which have resulted or may in the future develop [from the accident]." The $50,000 check contained an annotation that it was "in settlement of any [and] all claims," and the cover letter enclosing the check and release stated that "the delivery of this [check] is conditioned upon your client signing the enclosed Release in unaltered form, and the document being returned . . . prior to disbursement." Stanford's counsel objected to the release and settlement language on the check. NGM thereafter reissued the check with language that stated "satisfaction of UM Arbitration Award." One week later, Stanford filed suit alleging bad faith and breach of contract.

In analyzing Stanford's bad faith claim, the court explained, "a cause of action for the bad faith delay, or the nonpayment, of an insured's claim in a first-party insured-insurer relationship is cognizable under Delaware law as a breach of contractual obligations" (quotations and citations omitted). To prevail on a bad faith claim, a plaintiff must show that "the insurer's refusal to honor its contractual obligation was clearly without any reasonable justification" (quotations and citations omitted). "Mere delay is not evidence of bad faith, provided that a reasonable justification exists for refusing to make payment upon submission of proof of loss" (quotations and citations omitted).

Stanford offered four reasons why the court should rule that NGM acted in bad faith: "(1) NGM delayed in handling [Stanford's underinsured motorist] claim by requesting that [Stanford] submit to an [examination under oath] and medical examination; (2) NGM's $10,000 pre-arbitration settlement offer was inadequate and made in bad faith; (3) NGM delayed payment of the arbitration award; and (4) NGM acted in bad faith by conditioning the payment of the arbitration award on [Stanford] signing a waiver of claims arising from the accident."

The court rejected each of these reasons. First, the insurance policy required Stanford to submit to examinations under oath, and medical examinations. "[T]o the extent that [Stanford] contends that NGM's investigation of or delay in making an offer to settle the claim was in bad faith, NGM believed that [Stanford] failed to comply with the insurance policy requirements."

Second, the court found that NGM had reasonable grounds to limit its settlement offer to $10,000. At the time of the accident, Stanford had a Delaware residence and driver's license. NGM believed that Stanford's claim would be governed by Delaware law, and Delaware law prohibits the stacking of uninsured and underinsured motorist coverages. Thus, if Delaware law applied to the arbitration proceeding, Stanford would have been entitled to a maximum of $25,000 in uninsured/underinsured motorist benefits, not $50,000. However, the arbitrators ultimately ruled that Pennsylvania law – which permits stacking of uninsured and underinsured motorist coverage – applied to Stanford's claim.

Third, the court ruled that NGM had reasonable grounds for delaying payment of the $50,000 arbitration award. After the arbitrators issued their decision, NGM considered its appellate options under both Delaware and Pennsylvania law. Under Delaware law, NGM had ninety days to appeal; under Pennsylvania law, NGM had thirty days. NGM issued Stanford a check and release three days before the deadline to appeal under Pennsylvania law. After Stanford objected to the check and release, and on the deadline to appeal the arbitration award, NGM prepared a new check with corrected language and sent it via overnight mail to Stanford. Stanford received the new check one day after the deadline to appeal. The court ruled that "[t]he mere fact that NGM issued the check one day after the deadline to appeal is insufficient to demonstrate bad faith because NGM had a reasonable justification for the delay."

Lastly, the court rejected Stanford's argument that NGM acted in bad faith by conditioning payment of the award on execution of a release. First, NGM promptly reissued a check and withdrew any requirement that Stanford sign a release. Second, NGM's counsel testified that providing a release with a settlement check was standard practice in Delaware and that NGM relied on this practice in initially conditioning the award on execution of the release. The court noted that Stanford failed to provide any evidence that this was not standard practice in Delaware.

The court ruled that Pennsylvania law governed Stanford's breach of contract claim. "An action for breach of an insurance contract does not lie when the policy proceeds have been paid because in such cases, an insured cannot establish damages under the contract" (internal quotations and citations omitted). NGM paid Stanford the limits under the policy ($50,000). As a result, Stanford suffered no damages under the insurance contract and Stanford's breach of contract claim failed.

Stanford also argued that NGM breached its fiduciary duty to Stanford, but the court rejected this argument. Under Pennsylvania law, a fiduciary duty "does not arise from an insurance contract until an insurer asserts a stated right under the policy to handle all claims asserted against the insured" (internal quotations and citation omitted). The court ruled that NGM did not owe a fiduciary duty to Stanford because there was no evidence that NGM asserted any right to handle claims made against Stanford.

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