

# COUNTERPOINT

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## BAD FAITH CLAIMS CONTINUE TO OCCUPY THE COURTS

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### INTRODUCTION<sup>1</sup>

The year 2008 saw approximately fifty (50) decisions handed down by the state and federal courts addressing various issues under Pennsylvania's Bad Faith Statute, 42 Pa. C.S.A. §8371, or under the common law applicable to insurer claims handling. Of the written opinions (i.e. those included in the reporters or on Lexis and/or Westlaw), no decisions were from the Supreme Court, two were from the Superior Court, and four were from the Third Circuit Court of Appeals. The great majority of the opinions (about four-fifths) were from the federal district courts, with almost half of those from the Eastern District. The courts of common pleas issued written opinions in only a handful of cases. Collectively, these

decisions demonstrate that claims of insurer bad faith continue to be brought at a steady clip, even as courts work to resolve many of the attendant issues, particularly those wrought by §8371's sparse statutory language. Here follows a short discussion of some of the more interesting decisions of the past twelve months.

### WHERE INSURER'S CLAIMS HANDLING IS REASONABLE, SUMMARY JUDGMENT IN FAVOR OF INSURER WILL BE GRANTED

While adverse bad faith verdicts get all the publicity, the fact remains that courts regularly find that an insurer's investigation and claims decision was *reasonable* and that bad faith did *not*

occur. Insurers are quite often successful in obtaining summary judgment, a result assisted by the fact that the insured must prove the elements of a bad faith case by *clear and convincing evidence*. The courts have universally observed that "the insured's burden in opposing a summary judgment motion brought by the insurer is commensurately high because the court must view the evidence presented in light of the substantive evidentiary burden at trial." See e.g., *Oehlmann v. Metro. Life Ins. Co.*, 2007 U.S. Dist. LEXIS 93899 (M.D. Pa. Dec. 21, 2007); *Tuschak v. State Farm Mutual Automobile Insurance Company*, 2008 U.S. Dist. LEXIS 55020 (W.D. Pa. July 14, 2008).

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judgment on bad faith in favor of life insurer which denied beneficiary's claim based upon misrepresentations in policy application made 10 months before decedent's death).

*Tuschak v. State Farm Mutual Automobile Insurance Company*, 2008 U.S. Dist. LEXIS 55020 (W.D. Pa. July 14, 2008) (Ambrose, J.) (summary judgment on bad faith in favor of automobile insurer which denied car theft claim based upon fraud by the insured).

### THIRD CIRCUIT REDUCES PUNITIVE AWARD TO 1:1 RATIO

*Jurinko v. Medical Protective Company*, 2008 U.S. App. LEXIS 26263 (December 24, 2008) involved a third party bad faith lawsuit against a medical professional liability insurer in connection with the insurer's failure to settle a medical malpractice suit that resulted in an excess verdict. The bad faith case went to trial before a federal court jury and resulted in an award to the assignee of the insured of \$1,658,345 in compensatory damages (representing the amount of excess verdict, as stipulated by the parties) and \$6.25 million in punitive damages. The district court rejected the insurer's post-verdict motions challenging the finding of bad faith and the size of the punitive damage award. The court also held that the punitive damages award was less than four times the award of compensatory damages and thus was not excessive. The insurer appealed the decision to the Third Circuit on a number of grounds including the ratio of punitive to compensatory damages.

Chief Judge Scirica authored the opinion for the Court of Appeals, which, in a unanimous decision, held that the district court's punitive damages award was "unconstitutionally excessive" and should be reduced to \$1,996,950.56, the amount of the excess verdict plus attorneys' fees. *Jurinko v. Medical Protective Company*, 2008 U.S. App. LEXIS 26263 at \*56. Relying upon the principles set forth in *BMW of North America, Inc. v. Gore*, 517 U.S. 559 (1996) and *State Farm Mutual. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003), the Court of Appeals stated:

Here, the ratio is 3.13:1. High ratios do not violate due process if "a particularly egregious act has resulted in only a small amount of economic damages," or if "the injury is hard

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In the following cases the courts rejected claims of bad faith, finding, on summary judgment, that the insurer's claims handling was reasonable:

*Blaylock v. Allstate Insurance Company*, 2008 U.S. Dist. LEXIS 1098 (M.D. Pa. January 7, 2008) (Caldwell, J.) (summary judgment on bad faith in favor of UM insurer).

*Easy Sportswear, Inc. v. American Economy Insurance Company*, 2007 U.S. Dist. LEXIS 86114 (W.D. Pa. November 21, 2007) (Fischer, J.) (summary judgment on bad faith in favor of property insurer adjusting Hurricane Ivan claim).

*Allison v. Allstate Indemnity Company*, 2008 U.S. Dist. LEXIS 50684 (E.D. Pa. June 27, 2008) (Rice, M. J.) (summary judgment on bad faith in favor of homeowner's insurer adjusting storm damage claim).

*Miller v. First Liberty Insurance Corporation*, 2008 U.S. Dist. LEXIS 47550 (E.D. Pa. June 17, 2008) (O'Neill, J.) (summary judgment on bad faith in favor of homeowner's insurer which denied termite infestation claim).

*Kidd v. Prudential Insurance Company of America*, 2008 U.S. Dist. LEXIS 2934 (M.D. Pa. January 15, 2008) (Blewitt, M. J.) (summary judgment in favor of life insurer because policy had lapsed).

*Oehlmann v. Metro. Life Ins. Co.*, 2007 U.S. Dist. LEXIS 93899 (M.D. Pa. Dec. 21, 2007) (Kosik, J.) (summary judgment on bad faith in favor of life

insurer which delayed resolution of death claim as a result of a beneficiary dispute).

*McCullough v. Northwestern Mutual Life Insurance Company*, 2007 U.S. Dist. LEXIS 95134 (W.D. Pa. October 24, 2007) (Cercone, J.) (summary judgment on bad faith in favor of disability insurer which obtained medical review and surveillance prior to denying claim).

*Schaeffer v. Allianz Life Insurance Company of North America*, 2008 U.S. Dist. LEXIS 44939 (E.D. Pa. 2008) (Fullam, J.) (summary judgment on bad faith in favor of disability insurer which sought rescission based upon misrepresentations in policy application).

*Simon Wrecking Company, Inc. v. AIU Insurance Co.*, 530 F. Supp. 2d 706, 717-718 (E.D. Pa. 2008) (Brody, J.) (summary judgment on bad faith in favor of CGL carrier which denied claim and litigated coverage question concerning pollution exclusion).

*Leach v. Northwestern Mutual Insurance Company*, 2006 U.S. Dist. LEXIS 83624 (W.D. Pa. Nov. 16, 2006) (Cohill, J.), *affirmed*, 2008 U.S. App. LEXIS 1990 (U.S. 3d Cir. January 29, 2008) (Jordan, J.) (summary judgment on bad faith in favor of disability insurer which denied claim when investigation suggested insured has misrepresented the extent of his claimed disability).

*Scheibler v. AMERICO Financial Life and Annuity Insurance Company, et al.*, 2007 Pa. Dist. & Cnty. Dec. LEXIS 324 (Westmoreland July 24, 2007) (Ackerman, J.) (summary

to detect or the monetary value of noneconomic harm might have been difficult to determine." . . . Here the compensatory damages are substantial, Dr. Marcincin suffered only economic harm, and the harm was easily measured -- it was the amount of the excess judgment. Medical Protective's acts were egregious, but not likely "particularly" egregious. *Campbell* counsels, under these circumstances, that only a lesser award satisfies due process.

*Jurinko v. Medical Protective Company*, 2008 U.S. App. LEXIS 26263 at \*41-\*42. The Court of Appeals held that where the award of compensatory damages was substantial, a reduced punitive award reflecting a 1:1 ratio was appropriate:

With regard to the proper ratio, the Supreme Court has instructed that "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee." *Campbell*, 538 U.S. at 425. We believe, in light of our consideration of all three guideposts, the Supreme Court's statement instructs the outcome here. Accordingly, we will reduce the award to reflect a 1:1 ratio.

*Id.* at \*48 (citing *Campbell*, 538 U.S. at 425).

#### PHILADELPHIA JUDGE HOLDS SECTION 8371 INAPPLICABLE OUT OF STATE

*Lewittman v. Mt. Vernon Fire Ins. Co.*, 2008 Phila. Ct. Com. Pl. LEXIS 265 (Pa. C.P. 2008) (Bernstein, J.) arose from a building fire in Maryland. The plaintiffs were not Pennsylvania residents but sued their Pennsylvania insurance carrier under §8371 in connection with the claim. The insurer filed preliminary objections seeking dismissal of the case with leave to re-file in Maryland on *forum non conveniens* grounds. Judge Bernstein of the Philadelphia Court of Common Pleas granted the insurer's preliminary objections based on the court's view that the plaintiffs established no connection to Pennsylvania beyond the location of the insurer. The court also held that Maryland insurance law, and not Pennsylvania bad faith law would apply, finding that "[t]he Pennsylvania Bad Faith Statute cannot have general extraterritorial application for every

insurance company doing business in Pennsylvania nor even for insurance companies incorporated in or even principally located in Pennsylvania." *Id.* at \*9-\*10. In the court's view, if the bad faith statute was permitted such "extraterritorial application," then Pennsylvania insurers "would have a unique, oppressive and oftentimes impossible burden because they would be subject to both the Pennsylvania claims handling requirements and the potentially contradictory requirements of the state in which an insured's property was located." *Id.*

#### APPLICABILITY OF THE UIPA AND UCSP REGULATIONS QUESTIONED

In the 1994 case of *Romano v. Nationwide Mutual Fire Insurance Company*, 646 A.2d 1228, 1232 (Pa. Super. 1994), the Superior Court held that in determining whether bad faith exists, courts may look to the requirements of the Unfair Insurance Practices Act (UIPA) and Unfair Claims Settlement Practice Regulations (UCSPR). However, some recent cases have questioned whether *Romano's* reference to the UIPA and its regulations is consistent with the two-part definition of bad faith laid down in *Terletsky v. Prudential Prop. & Cas. Ins. Co.*, 649 A. 2d 680 (Pa. Super 1994) (holding that to prove bad faith, a plaintiff must show by clear and convincing evidence that the insurer (1) did not have a reasonable basis for denying benefits under the policy and (2) knew or recklessly disregarded its lack of a reasonable basis in denying the claim.).

In *Oehlmann v. Metro. Life Ins. Co.*, 2007 U.S. Dist. LEXIS 93899 (M.D. Pa. Dec. 21, 2007) (Kosik, J.), the court granted summary judgment in favor of the insurer and rejected plaintiff's reliance on alleged violations of the UIPA and the UCSPR, stating:

We. . . reject that the alleged violations of UIPA and UCSP are bad faith per se for the following reasons. First, the standard for judging legal bad faith in section 8371 actions is the *Terletsky* test. Therefore, that an insurer may have allegedly violated a regulatory standard is irrelevant to our analysis. Second, the UIPA and the UCSP are designed to be implemented and enforced by the Insurance Commissioner of Pennsylvania -- it is not our province to usurp the

Commissioner's power in this regard by de facto regulation of the insurance industry under the guise of section 8371. . . . Finally, the UIPA attempts to prevent and regulate violations systemic in the insurance industry, as only violations committed "with a frequency that indicated a general business practice" are sanctionable. . . . Regulations designed for an industry are inapposite to evaluating an individual episode of alleged bad faith. . . .

*Id.* at \*22-\*24. *Accord: Moss Signs, Inc. v. State Automobile Mutual Insurance Company*, 2008 U.S. Dist. LEXIS 26770 (W.D. Pa. April 2, 2008) (Standish, J.) ("We agree with the analysis of *Oehlmann* . . ."); *Leach v. Northwestern Mutual Insurance Company*, 2008 U.S. App. LEXIS 1990 (3d Cir. January 29, 2008) ("[T]he District Court did not err in finding that, insofar as Leach's claim for bad faith was based upon an alleged violation of the UIPA, it failed as a matter of law.").

#### NO BAD FAITH DESPITE ALLEGATIONS OF DELAY

While delay is a relevant factor in determining whether bad faith has occurred, mere delay, without more, does not establish bad faith, and an insurer's failure to communicate in a timely fashion with its insured does not necessarily establish bad faith. During the claims process in *Greene v. United Services Automobile Association*, 936 A.2d 1178 (Pa. Super. 2007), there were several pieces of correspondence that were not responded to by the insurer, and an 8-month delay in paying one aspect of the property claim. The Superior Court found that the plaintiffs had not proven bad faith with respect to the exchange of correspondence and the late payment, stating, "[W]e were not convinced, by clear and convincing evidence that USAA acted in bad faith, or with dishonest purpose, ill-will, or self interest. At most, the above evidence indicates that [the claims adjuster] failed to respond to one letter, and return a few of [plaintiffs'] phone calls. And while it is clear that [the claims adjuster] failed to issue the last coverage check for eight (8) months, we view such inaction as inadvertence rather than an act of ill will." *Id.* at 1189.

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### MIXED SIGNALS: WHERE LIABILITY INSURER DEFENDS AND RESERVES RIGHTS

It has been generally recognized that an insurer does not act in bad faith by investigating and litigating legitimate issues of coverage. It follows that an insurer should be free to file a declaratory judgment action to determine a coverage issue without incurring accusations of bad faith. However, the courts have sent mixed signals on this issue.

In *Gideon v. Nationwide Mutual Fire Insurance Company*, 2008 U.S. Dist. LEXIS 26729 (W.D. Pa. March 20, 2008) (Cohill, J.), Nationwide opted to defend a suit against its insured subject to a reservation of rights, while at the same time filing a declaratory judgment action seeking a determination that there was no coverage. Judge Cohill of the Western District rejected the insurer's motion to dismiss, and permitted a bad faith claim to proceed, stating that "if an insurer provides a defense, reserves its rights, and files a declaratory judgment action, said conduct constitutes a denial of an insured's claim." *Id.* at \*14.

Most insurers would not view the providing of a defense subject to a reservation of rights as a "claim denial" that would be subject to a bad faith action. To the contrary, insurers view the providing of such a defense, despite valid coverage questions, as the hallmark of *good* faith. A declaratory judgment action is a logical and favored method for a final determination of a coverage dispute. Thus, the premise of the court in *Gideon* is questionable.

It is submitted that better reasoning is found in the decision of Judge Padova of the Eastern District in *Victoria Insurance Company v. Li He Ren*, 2008 U.S. Dist. LEXIS 44674 (E.D. Pa. June 9, 2008) (Padova, J.). In that case the insurer, relying upon a policy exclusion

pertaining to independent contractors, defended the insured subject to a reservation of rights and filed a separate coverage action. The court found that the insurer "proceeded as we expect a responsible insurer to proceed when it has a legitimate coverage question; it has assumed the defense [of the insured] in the State Court action and filed a declaratory judgment action in this Court." *Id.* at \*11. The court concluded, "Given that an insurer does not act in bad faith by asserting legitimate and reasonable coverage defenses, it is also plain that an insurer does not act in bad faith merely by initiating a declaratory judgment action." *Id.*

### FEDERAL COURT REMOVAL

In the last few years the federal district courts have appeared to limit the ability of insurers to remove bad faith cases to federal court, perhaps leading some insurers to reasonably inquire whether the federal courthouse doors have been locked too tight.

One way that counsel for insureds have sought to prevent removal is to join a non-diverse party as a co-defendant. In *Kenia v. Nationwide Mutual Insurance Company*, 2008 U.S. Dist. LEXIS 5547 (M.D. Pa. January 25, 2008) (Jones, J.), the insured's bad faith complaint named the insurer and several claim representatives as defendants, and included a count alleging violation of the Pennsylvania Unfair Trade Practices and Consumer Protection law ("UTPCPL"), 73 Pa. Stat. Ann. section 2:01-1 *et seq.* The insurer removed the case to federal court, alleging that there was diversity of citizenship between the insured and insurer, and that the joinder of the non-diverse claim representatives was fraudulent. Judge Jones of the Middle District granted the insured's motion to remand the case to state court. The court felt that the insurer had not satisfied its "heavy burden" of showing that the resident claims representatives were fraudulently joined since at least a colorable claim of UTPCPL violations

was made against those defendants, and therefore there was a lack of the requisite citizenship diversity.

Similarly, in *Marsico v. The UNUM Group*, 2007 U.S. Dist. LEXIS 87471 (W.D. Pa. November 28, 2007) (Schwab, J.), the plaintiff sued his disability insurer as well as an IME physician, who was a Pennsylvania resident. Plaintiff alleged that the insurer acted in bad faith in denying his claim. He also alleged wrongdoing on the part of the IME physician. The insurer removed the case to federal court, taking the position that the physician was fraudulently joined. The court remanded the case because it felt that the plaintiff had set forth a colorable claim against the physician, and concluded that he was not fraudulently joined in an effort to defeat diversity of citizenship.

Courts have held that suits arbitrable pursuant to state court compulsory arbitration rules are not removable -- even though, on a *de novo* appeal, a plaintiff would be permitted to seek damages greater than \$75,000, the federal jurisdictional limit. Thus in *Dunfee v. Allstate Insurance Company*, 2008 U.S. Dist. LEXIS 49955 (E.D. Pa. June 27, 2008) (Baylson, J.), the insureds' complaint alleged breach of contract and demanded judgment "in an amount not in excess of \$50,000;" and a separate count alleging bad faith and seeking punitive damages, counsel fees, and interest in an amount not in excess of \$50,000. In rejecting the insurer's attempted removal, the district court concluded that since the plaintiff had limited each count's claims to no more than \$50,000, the insurer had not met its burden to justify removal in this case.

### ENDNOTE

<sup>1</sup> Michael J. Farrell, Esquire, a senior associate with Post & Schell, P.C. provided assistance in the research and preparation of this article.

