

# The Bad Faith Sentinel

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

## Mixed result in Katrina bad faith claim

*Merely reviewing the insured's photographs of damage, rather than reviewing in person, creates a jury issue regarding "bad faith"; History of stress-related health issues precluded recovery of damages for such injuries claimed as a result of insurer's conduct. [Khalimsky v. Liberty Mutual Fire Ins. Co.](#), No. 01-8959, 2009 WL 982641 (E.D. La. April 13, 2009).*

A federal District Court in Louisiana recently granted in part and denied in part an insurer's motion for summary judgment in a bad faith claim following Hurricane Katrina. Plaintiff Khalimsky owned a home in New Orleans that was covered under a homeowner's policy issued by Liberty Mutual. During the hurricane, the first floor of Khalimsky's house was flooded, destroying the house and its contents below the flood level. Two months later, an insurance adjuster inspected the home. The adjuster approved payment for repairs to the roof, but refused to look at the attic as requested by Khalimsky. The adjuster instead instructed Khalimsky to send pictures of any such damage. Based on the resulting estimate, Liberty paid Khalimsky \$1,113.51 for wind damage above the flood line. Khalimsky, unsatisfied with the estimate, called both the adjuster and Liberty Mutual to request an additional adjustment, specifically asking that someone look at the attic. After his requests for another adjustment were denied, Khalimsky sent Liberty Mutual photographic evidence of damage and subsequently received an additional \$1,095.42 for damage and \$4,000 for loss of use.

Khalimsky later filed suit claiming that he was not paid the full value of his loss for the dwelling, contents, or use and that Liberty's adjustment and subsequent failure to pay was "arbitrary and capricious" and thus, in bad faith within the meaning of Louisiana's Bad Faith Statute. See La. Rev. Stat. Ann. §§ 22:1220, 22:658. In addition, Khalimsky claimed that the bad faith adjustment caused or contributed to a stroke he suffered in December 2005.

The Court denied that portion of Liberty Mutual's motion for summary judgment related to the cause of action for "bad faith." It found that a reasonable fact-finder could find that Liberty Mutual's failure to investigate the attic for damage was arbitrary and capricious. The Court held that "a reasonable fact-finder could conclude that sufficient warning signs existed to make it

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unreasonable for [the adjuster] not [to] inspect [sic] Plaintiff's attic and that, had he done so, as a trained adjuster he would have discovered the evidence of additional roof damage." Conversely, a reasonable fact-finder could determine that the adjuster's inspection was in good-faith, or that he would not have discovered the evidence of roof damage, or that there was in fact no additional, uncompensated damage to Khalimsky's home. As such, the Court determined a genuine issue of material fact existed as to the bad faith of the adjustment and denied the motion for summary judgment.

The Court did grant Liberty Mutual's motion for summary judgment on Khalimsky's demand for damages related to mental anguish, medical expenses and loss of income. Relying on a recent Fifth Circuit decision, the Court noted that insurers can be liable for men-

tal anguish and other general damages resulting from a breach of the Louisiana bad faith statute. See *Dickerson v. United States*, 556 F.3d 290, 303-04 (5th Cir. 2009). In light of testimony that Khalimsky's personality was altered after the hurricane – his formerly calm demeanor was replaced with constant frustration and stress, particularly during phone conversations with Liberty Mutual representatives – the Court concluded there was ample evidence of mental anguish resulting from Liberty Mutual's conduct. Despite this conclusion, the Court held that "Liberty Mutual's alleged breach was not a harm within the risk of a bad faith insurance adjustment." The Court explained that although the harm of mental anguish is generally within such risk, when the insured has a history of heart disease and damaging lifestyle factors, as was the case here, it was unwilling to "say that a stroke is a foreseeable harm within the risk of a bad faith breach of a contract of insurance."

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## Mississippi court grants summary judgment on bad faith claim

*Insurer's partial payment with check purporting to provide for "full and final settlement" of claim insufficient to support a claim for punitive damages. [Bryant v. Prime Ins. Syndicate](#), No. 1:07CV1126-LG-RHW, 2009 WL 982792 (S.D. Miss. April 13, 2009).*

In 2004, Prime issued a homeowner's insurance policy, including coverage for wind damage, for Plaintiffs' home in Gulfport, Mississippi. On August 29, 2005, Hurricane Katrina blew trees onto the Plaintiffs' home, allowing rainwater to enter the structure. Plaintiffs filed a claim with Prime and Prime subsequently sent an adjuster to the property. The adjuster determined that the actual cash value of the damage to the dwelling was \$27,534.63, damage to other structures on the property was \$2,305.95, and noted that the contents list should be reviewed to determine the value of that damage. Prime, after receiving the adjuster's report, sent Plaintiffs a check for \$27,790.58. The check was marked "full and final settlement of any and all dwelling claims arising on or about August 29, 2005." Plaintiffs refused to cash the check and returned it to Prime because of the "full and final settlement" language. Plaintiffs then notified Prime that its payment was insufficient to cover the damage to their property and did not include a settlement of the contents claim. Prime informed Plaintiffs that they needed to submit a proof of loss for the contents claim and

hire their own adjuster if they disagreed with the amount paid. Plaintiffs did hire their own adjuster and in February 2007, Prime sent Plaintiffs three checks totaling \$54,832.22.

Plaintiffs filed a complaint in October 2007 alleging, in part, that Prime acted in bad faith by conditioning its payment on a full and final release of all property damage claims and by failing to timely investigate the contents claim. In Mississippi, the issue of whether an insured should recover punitive damages for an insurer's bad faith is not to be submitted to a jury unless the trial court determines there are issues with regard to whether: (1) the insurer lacked an arguable or legitimate basis for denying the claim; and (2) the insurer committed a willful or malicious wrong, or acted with gross and reckless disregard for the insured's rights. See *United Am. Ins. Co. v. Merrill*, 978 So.2d 613, 634 (Miss. 2007).

The Southern District of Mississippi found that Prime had an arguable reason not to pay for contents damage until after apprais-

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al, and that because Prime paid the Plaintiffs the policy limits for their contents after the appraisal, there was no bad faith. The Court found that an issue of material fact existed regarding whether Prime had a reasonable basis for placing the “full and final” language on the initial check. Despite this, it concluded that

even if Prime lacked an arguable basis for including the language on the check, the conduct merely rose to the level of simple negligence. As such, the Court granted Prime’s motion for summary judgment with regard to the Plaintiffs’ bad faith claim.

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## Seventh Circuit Rebukes Unfounded Bad Faith Allegations

*Seventh Circuit notes that frivolous “bad faith” claim can damage an insured’s credibility. [Westfield Ins. Co. v. Sheehan Construction Co.](#), No. 08-3463, 2009 WL 1139331 (7th Cir. April 29, 2009).*

The Seventh Circuit recently took a litigant to task for what the Court perceived to be unsubstantiated allegations of bad faith. The owners of houses in a residential subdivision noticed building defects that were traced back to the general contractor. State court litigation resulted in a settlement of \$2.8 million, which the contractor argued that Westfield, its insurer, should pay. Westfield declined to pay and instead filed a declaratory-judgment action. The Court held that the policy excluded coverage for the claimed damages to the new homes. Although the Seventh Circuit found that the contractor’s bad faith claim lacked merit, it did offer an interesting analysis:

We cannot refrain from remarking . . . that Sheehan’s insistence that it is entitled to punitive damages because Westfield’s denial of coverage was “in bad faith” is the sort of argument that calls into question the bona fides of

all other contentions. How can an insurer exhibit “bad faith” by taking a position that not only follows the policy’s language but also is endorsed by a district judge? We can imagine a procedural form of bad faith—refusal to take any stance on the policy’s coverage while leaving the insured to fend for itself in the underlying litigation—but Westfield addressed Sheehan’s claim with dispatch and filed a prompt declaratory-judgment suit to have the dispute resolved. Sheehan’s insistence, even after losing on the merits in the district court, that the insurer acted “in bad faith” implies that its strategy has been to strong-arm a settlement by *in terrorem* claims, rather than to vindicate its legal entitlements. Lawyers should think carefully about the message that their contentions convey to the court, as well as the effect they may have on the other litigants.

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## Kentucky Court Declines to Bifurcate Bad Faith Claims

*Refusal to bifurcate coverage and bad faith cases where issues are “inextricably intertwined,” i.e. bad faith is based on an allegedly wrongful denial of coverage. [Lively v. USAA Casualty Ins. Co.](#), No. 08-422-JMH, 2009 WL 1116327 (E.D. Ky. April 24, 2009).*

On October 28, 2007, a duplex owned by Plaintiffs was destroyed by fire. The dwelling was insured against loss by fire under an insurance policy issued by USAA. Plaintiffs alleged that following the destruction of the dwelling, USAA refused to pay the benefits due under the policy, resulting in a breach of the contract of insurance. Plaintiffs also claimed that USAA acted in bad faith in deny-

ing their claim, violating Kentucky’s Unfair Claims Settlement Practices Act.

USAA moved to bifurcate the bad faith claim from the underlying breach of contract claim, arguing that until and unless the Plaintiffs prevailed on the breach of contract claim, it was unnecessary to

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reach the bad faith claim. Plaintiffs, in response, argued that the central question in both claims was whether the Defendant “had a reasonable basis for denying their claim.” Kentucky law “generally favors bifurcation in third-party actions where the plaintiff asserts a claim for liability against the insured defendant and a bad faith claim against the defendant’s insurer.” However, the case at hand was a first-party action involving the question of whether the defendant was obligated to pay the plaintiffs’ claims and acted in bad faith by refusing payment.

The District Court in the Eastern District of Kentucky, persuaded by a case out of the Western District, *Tharpe v. Illinois Nat. Ins. Co.*, 199 F.R.D. 213 (W.D.Ky.2001), held “there is no purpose to be served by bifurcation of the breach of contract and bad faith claims.” Because the Defendant’s evidence would be the same to show both that it did not breach the contract and that it had a reasonable basis to deny the claim, the two issues are “inextricably

intertwined.” The Court also held that with the use of “carefully drafted jury instructions,” there is little risk the jury is “likely to measure the Defendant’s conduct in the case *sub judice*, but on a combination of situations that may be utilized to prove alleged acts of ‘bad faith’” as was suggested by the insurer.

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