

# The Bad Faith Sentinel

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## CONTENTS

**Third Circuit holds insurer's failure to follow its own best practices not bad faith**  
pages 1 - 2

**Ninth Circuit holds insurer did not act in bad faith by requesting an IME before approving insured's medical treatment**  
page 2

**Florida court finds bad faith claim ripe for prosecution before exhaustion of insurer's appellate remedies as to liability and loss amount**  
pages 3 - 4

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

## Third Circuit holds insurer's failure to follow its own best practices not bad faith

Although insurer should have followed its own best practices, the Third Circuit concluded it was not bad faith to deviate from those standards. *Smith v. Continental Cas. Co., No. 08-4140, 2009 WL 3214234 (3d Cir. Oct. 8, 2009).*

Stacey and Marjorie Smith hired James Sprecher, a financial advisor insured by Continental, to plan their long-term investment portfolio. Sprecher invested the Smiths' money in Evergreen Securities, an unregistered off-shore entity that was later revealed as a "massive Ponzi scheme." The Smiths sued Sprecher, asserting claims for breach of contract, negligent misrepresentation, breach of fiduciary duty, and violations of Pennsylvania consumer protection and securities laws. Continental denied Sprecher coverage and a defense in the suit. The Smiths eventually settled with Sprecher for \$150,000 and an assignment of Sprecher's rights against Continental.

After their settlement with Sprecher, the Smiths sued Continental in their role as Sprecher's assignees for breach of contract and bad faith denial of insurance coverage under his professional liability policy. The policy contained an exclusion from coverage for any claim "against a Registered Representative or Registered Investment Adviser involving services or products not approved by [the] Broker/Dealer [in question]." The Third Circuit, relying on this exclusion, affirmed the district court's grant of summary judgment to Continental on the breach of contract claim. The Court held that the exclusion was applicable because Sprecher's Broker/Dealer employer did not approve the investment in Evergreen.

The Third Circuit also upheld the district court's grant of summary judgment to Continental on the claim for bad faith denial of coverage. The Smiths argued that Continental's investigation of the claim was inadequate because it was conducted by outside counsel and because Continental's claims handler attended only two meetings regarding claims against Sprecher. The Court concluded that the Smiths could not establish by clear and convincing evidence that Continental had no reasonable basis for denying the benefits. As the district court noted, Continental engaged experienced coverage counsel to evaluate Sprecher's claims, met with

## The Bad Faith Sentinel

coverage counsel to discuss the claims, and spoke with representatives of Sprecher's employers in gathering information regarding the claim.

The Smiths also argued that Continental acted in bad faith because the insurer did not contact Sprecher prior to denying coverage, in contravention of its own claims handling guidelines, which stated that "[c]laim professionals should attempt to contact the insured or their representative" and "[s]olicit the insured's comments regarding the allegations being made by the claimant." The district court noted that Continental contacted Sprecher's employers, and

based on the information gained through its investigation determined that there was no coverage irrespective of Sprecher's comments regarding the claims against him. In its opinion, the Third Circuit upheld the district court's ruling that "[a]lthough failing to contact Sprecher prior to denying coverage was perhaps not a 'best practice' and may have shown bad judgment by Continental, such conduct is not evidence of bad faith." The Third Circuit explained that even though Continental should have spoken with Sprecher before it made a final coverage decision, such a failure to follow best practices does not give rise to a bad faith claim.

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## Ninth Circuit holds insurer did not act in bad faith by requesting an IME before approving insured's medical treatment

Pursuant to Washington law, insurers can request an IME of medical treatment pursuant to PIP coverage and any resulting delay in treatment does not constitute bad faith. *Sadler v. State Mutual Auto. Ins. Co.*, No. 08-35859, 2009 WL 3634206 (9th Cir. Nov. 4, 2009).

Tara Sadler initiated a claim for Personal Injury Protection ("PIP") benefits under an insurance policy from State Farm after she was allegedly injured in a car accident. After a course of physical therapy and chiropractic care, Sadler opted to have surgery to treat her alleged neck pain. State Farm requested an independent medical examination ("IME") of Sadler before it would pay for the surgery. The IME report indicated that surgery was necessary. Based on the report, a State Farm representative said the surgery seemed reasonable. Sadler's doctors were hesitant to perform the surgery without a pre-procedure promise to pay, but State Farm indicated that it was not its policy to pre-approve or pre-pay for any medical procedures. Sadler eventually underwent two surgeries, the results of which were unfavorable. One of Sadler's doctors indicated that had the surgeries been performed earlier, the prognosis would have been better. Sadler filed a complaint against State Farm alleging breach of contract and bad faith claims handling, among other things.

The U.S. District Court for the Western District of Washington concluded that State Farm did not exacerbate Sadler's injuries by delaying payment of PIP benefits until Sadler received an IME. By its express terms, the PIP provision required only that State Farm reimburse Sadler or directly pay a treatment provider within thirty days after receiving proof of the amount due. The court concluded that Washington law does not indicate any duty of insurers to pre-approve or pre-pay treatment expenses, or to otherwise expedite its coverage decision.

The Ninth Circuit upheld the district court's decision to grant summary judgment in favor of State Farm. The Court explained that State Farm had a contractual right to obtain the IME, that as soon as State Farm learned of Sadler's request for surgery it scheduled the IME and that the IME report was completed about thirty-six days thereafter. Based on this, the Court concluded that there was no evidence indicating that State Farm's handling of the IME was atypical, contrary to law, unfounded, frivolous or otherwise unreasonable, and thus was not in bad faith.

## Florida court finds bad faith claim ripe for prosecution before exhaustion of insurer's appellate remedies as to liability and loss amount

Insurer's writ of certiorari requesting court to quash orders granting insured's request to proceed with statutory bad faith claim denied because insured not entitled to exhaust appellate remedies first. *State Farm Ins. Co. v. Seville Place Condo. Assoc.*, No. 3D08-2538, — So.3d —, 2009 WL 3271300 (Fla. App. Ct. Oct. 14, 2009).

Seville Place, a condominium in Miami Lakes, Florida, was substantially damaged in 2005 by Hurricane Wilma. At the time of the storm, Seville Place had a condominium association insurance policy with State Farm. The policy specifically covered direct physical loss or damage to the property caused by a hurricane and indicated that any "clear disagreement or dispute" between the insurer and insured regarding the loss amount would be resolved by appraisal. Seville Place made a claim under the policy for the hurricane-related loss, estimating the loss exceeded \$4.6 million, based on the need to replace all damaged portions of the buildings. State Farm paid Seville Place a total of \$90,564.62, based on an estimate to make repairs. Seville Place concluded that negotiation would be fruitless and so made a written demand for appraisal under the policy. State Farm responded to Seville Place's repair estimate and demand for appraisal, claiming there was "no clear disagreement" between the parties because State Farm had not yet been allowed access to all of the damaged units. State Farm said it would agree to the appraisal only if (1) any appraisal award was a line-item document, broken down by building and unit number; and (2) State Farm was provided with a sworn proof of loss form.

After its receipt of State Farm's conditions for appraisal, Seville Place commenced a court action against State Farm for breach of contract and for declaratory relief regarding coverage and State Farm's waiver of policy defenses. State Farm then filed its own motion to enforce the appraisal provision. The trial court ordered the parties to appraisal and appointed a neutral party to conduct the appraisal along with each party's designated appraiser. The court also granted Seville Place's motion for partial summary judgment regarding additional policy defenses, basing on the fact that State Farm had acknowledged that the loss was covered by

making the initial payments to the Association and only later denied the balance of the claim.

During the sixty-day period set by the court for appraisal, State Farm was granted one extension. The day before the rescheduled hearing, it filed an emergency motion seeking removal of the neutral umpire and requested an entirely new panel to conduct the appraisal. Seville Place's appraiser and the umpire ultimately signed a "final appraisal award" fixing the insured loss at \$2,960,405. The trial court confirmed the award, denied State Farm's emergency motion and granted Seville Place's motion to amend the complaint to add a statutory bad faith claim and a demand for punitive damages. The Court did not enter a final judgment fixing a total amount of principal or prejudgment interest in a form ready for execution.

State Farm sought a writ of certiorari from the Florida appellate court quashing the trial court orders that allowed Seville Place to proceed with a statutory bad faith claim and a punitive damage claim. State Farm argued that before a bad faith claim could proceed against it, Seville Place must obtain a final judgment on its original claim, a trial on certain affirmative defenses must occur and it must be allowed to exhaust all appellate remedies regarding the judgment.

In Florida, a statutory first-party bad faith action is premature until: (1) the insurer raises no defense which would defeat coverage, or any such defense has been adjudicated adversely to the insurer; and (2) the actual extent of the insured's loss has been determined. The appellate court held that both of these conditions were met. First, the court agreed with the trial court determination that State Farm waived most or all of its defenses to coverage by

## The Bad Faith Sentinel

acknowledging and paying a loss amount to the Association following the claim. Second, the court explained that the appraisers rendered a final appraisal award that was confirmed by the court and the only remaining action with regard to the judgment was wholly ministerial. The court held that State Farm's argument that the Association must obtain a final judgment before it can proceed with its bad faith and punitive damages claim was unsupported by Florida law. As such, the court held that Seville Place's bad faith claim was ripe for prosecution and denied the writ of certiorari.

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