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# The Bad Faith Sentinel

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

## California court draws distinction between unreasonable policy interpretation and unreasonable coverage denial

Although insurer could not anticipate state supreme court's new interpretation of a policy exclusion, once the court ruled on the exclusion's meaning, reliance on any other interpretation was unreasonable. *TRB Investments, Inc. v. Fireman's Fund Ins. Co.*, No. F055111, 2009 WL 4548341 (Cal. Ct. App. Dec. 7, 2009)

Fireman's Fund issued a property and liability insurance policy to TRB Investments covering a former bank building, which was leased to the Salvation Army through 2000. When the Salvation Army moved out of the building, TRB retained an architect and general contractor to redesign the space for a new tenant. Starting in April 2001, TRB began negotiating with a potential new tenant and on July 2, 2001, TRB and the new tenant entered into a lease agreement, pursuant to which TRB agreed to carry out further renovations. On July 16, workers discovered water damage caused by a broken water line. TRB filed a water-damage claim with Fireman's Fund on July 18, submitting invoices for repair work totaling \$155,261.68. After submitting the claim, TRB continued the renovations. In December, Fireman's Fund denied the claim relying on a vacancy exclusion in the policy.

The vacancy exclusion barred coverage for damage occurring in a building that has been vacant for more than 60 consecutive days before the loss. The policy defined "vacant" as a building that does not contain enough business personal property to conduct customary operations," but "buildings under construction are not considered vacant." The adjuster decided there was no coverage because the building was not under "construction" as the term was used in the policy, but was merely being renovated.

TRB filed a complaint alleging that by denying coverage, Fireman's Fund breached the insurance contract and violated the implied covenant of good faith and fair dealing. Fireman's Fund moved for summary adjudication arguing that the trial court should rule as a matter of law that a construction exception to a vacancy exclusion encompasses only new construction, not renovation. The trial court granted summary judgment for Fireman's Fund and the appellate court affirmed. The California Supreme Court reversed the decision, holding that the relevant inquiry was not whether the work was new construction or renovation, but whether there was a "substantial and continuing presence of workers at the premises." The Supreme Court

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remanded the matter to the trial court to permit the parties to bring new summary judgment motions based upon the newly articulated standard and citing additional facts.

Fireman's Fund did in fact file a new motion for summary adjudication, but it did not add facts about "the number of people associated with the construction project, how many hours per day or days per week they were in the building and how much of the building was occupied by these persons at any given time," as suggested by the Supreme Court. TRB, in contrast, did submit additional evidence in opposition to the motion, tabulating 884 person-hours of work on the building in June and July 2001. The trial court granted summary adjudication for Fireman's Fund

on the bad faith claim, holding that the company's "failure to anticipate the new rule [articulated by the Supreme Court] cannot be unreasonable." The court of appeals reversed the decision, holding that Fireman's Fund's initial policy interpretation was in fact unreasonable based on the facts presented and the Supreme Court's ruling.

The court of appeals indicated that its ruling did not establish bad faith as a matter of law and Fireman's Fund, on remand, had the opportunity to try to prove that, when it denied coverage, it had gathered enough facts to reasonably, though mistakenly, conclude that there was no substantial and continuing presence of workers at the premises when the loss occurred.

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## Washington court finds use of "may" in policy ambiguous and proper grounds for denial of summary judgment

*Equivocal policy language precludes grant of summary judgment for insurer, despite insured's misrepresentations of fact. **Ki Sin Kim v. Allstate Ins. Co.**, No. 37256-8-11, 2009 WL 4043373 (Wash. Ct. App. Nov. 24, 2009)*

On July 1, 2005, Kim was injured when a car driven by an uninsured motorist crossed the center line and collided head-on with her car. Twenty-one days later, Kim filed claims requesting coverage for her medical bills and wage loss under the personal injury protection and uninsured motorist provisions of her Allstate insurance policy. In her proof of loss statement, Kim indicated that the entire left side of her body hurt, particularly her shoulders, left ankle and left knee. She also indicated that because of her injuries she had not been able to return to work since the accident. As part of its investigation, Allstate hired a private investigator to observe Kim's activities over several days in September and October 2005. The investigator reported that not only did he observe Kim "walking, driving, [and] turning her head side to side," but also that he saw her working at the restaurant where she was employed. In October, Kim completed an independent medical examination during which the doctor noted he could not find any objective explanations for Kim's complaints of pain. The doctor concluded that Kim "feigned her physical injuries." During two depositions, Kim reiterated that she had not been back to work since the day of the accident.

In January 2006, Allstate denied coverage concluding that Kim had misrepresented the nature and extent of her injuries and her ability to work. The denial of coverage letter referenced the "Fraud or Misrepresentation" clause from Kim's policy, which provided that Allstate "may not" provide coverage if an insured intentionally misrepresents any material fact regarding the insured's claims.

Kim subsequently sued Allstate for nonpayment, arguing that Allstate acted in bad faith when it denied her claim. Allstate deposed Kim for a third time and Kim admitted that she had worked on several occasions since the accident. After the deposition, Allstate moved for summary judgment asking the trial court to find, as a matter of law, that Kim misrepresented material facts when she presented her claim and as a result her policy was void. Kim then filed a cross-motion for summary judgment arguing that Allstate committed bad faith by unreasonably failing to pay her emergency room bills. Finding that there were material issues of disputed fact as to whether Kim misrepresented the extent of her injuries and her ability to work, the trial court denied Allstate's

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summary judgment motion. The trial court then granted Kim's motion on her bad faith claim.

Allstate appealed the trial court's order on the bad-faith claim, contending that it was error to grant the motion in Kim's favor after denying Allstate's motion on the basis of a genuine issue of material fact. Specifically, Allstate argued that the summary judgment orders were irreconcilable because if Kim intentionally misrepresented a material fact to Allstate, her claims against the company for bad faith must fail.

The appellate court determined the record clearly established that Kim made misrepresentations regarding her ability to work and the extent of her injuries, but concluded that "in light of the equivocal language in Allstate's policy, a genuine issue of material fact remained as to the materiality of those misrepresentations with respect to Kim's emergency room visit." (emphasis added). The court held that the Allstate policy was unclear because it

stated only that Allstate "may not provide coverage for any insured who has made fraudulent statements." If the policy contained the clear and unequivocal language of other policies, e.g. "the entire policy is void if the insured willfully concealed or misrepresented any material fact," Kim's entire policy would be void based on the misrepresentations. Due to the policy language at issue, however, the extent of Allstate's insurance obligations to Kim regarding her emergency room visit was open to interpretation because there was no evidence that Kim made any misrepresentations during her initial visit to the emergency room. Further, the policy's use of the word "may" made it unclear under which circumstances Allstate would choose to deny coverage and to what extent the company's obligations were relieved by misrepresentations.

The appellate court upheld the denial of Allstate's motion for summary judgment in light of the equivocal policy language, but reversed the order granting Kim's motion, concluding that it was inconsistent with the other summary judgment order.

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## California court dismisses bad faith claim against insurer who denied coverage for arson by named insureds' son

Policy exclusion for criminal acts excluded coverage for innocent co-insureds, so it was not bad faith to deny coverage for fire started by insureds' son. *Century National Ins. Co. v. Garcia*, No. B209616, 2009 WL 4285796 (Cal. Ct. App. Dec. 2, 2009)

After a fire occurred at their home, the Garcias filed a claim with Century National, the company providing fire insurance for the property. Century National's adjuster, after an inspection of the premises, suspected the fire was the result of arson. Century National hired a qualified fire investigator to inspect the premises. The investigator concluded that the fire was intentionally started in the Garcias' son's room. The Garcias' son eventually pleaded no contest to arson charges and Century National filed a complaint for declaratory relief, seeking a declaration that it had no duty to pay the Garcias' claim. Century National relied on a policy exclusion for "intentional loss" including losses caused by "criminal conduct of

any insured." The Garcias subsequently filed a cross-complaint for breach of contract, breach of the covenant of good faith and fair dealing, and reformation. The Garcias alleged that their son was not a named insured on the policy and thus did not have an insurable interest in the property.

Century National filed a demurrer, contending that wrongdoing by the insured barred coverage and bad faith does not lie where there is a genuine dispute of law. The trial court sustained the demurrer finding that (1) the policy defined "any insured" to include relatives of the insured and (2) courts generally interpret policies which

exclude coverage for criminal or intentional acts to exclude coverage of innocent co-insureds. The appellate court upheld the lower court's decision, holding that because the Garcias' policy

defined insured as a relative of the named insured and excluded coverage for intentional loss, the arson was not covered. The court therefore dismissed the Garcias' bad faith claim.

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## Pennsylvania court holds it was not bad faith for insurer to file declaratory judgment action regarding STOLI scheme before claim made on the policy

Where there has been no claim for benefits and therefore no denial of any claim, an insurer's decision to file a declaratory judgment action is not sufficient to state a claim for bad faith. *Principal Life Ins. Co. v. DeRose, Civ. A. No. 1:08-CV-2294, 2009 WL 4061366 (M.D. Pa. Nov. 23, 2009)*

Principal brought a declaratory judgment action seeking entry of a judgment declaring that its obligations under a series of insurance policies issued on the life of JoAnn DeRose were not procured for legitimate purposes. Principal alleged that the policies were part of a "stranger originated life insurance" ("STOLI") scheme, and that the non-recourse premium financing used to pay for the premiums on the policies was concealed from Principal during the application process. In response to the complaint, the trustees of the DeRose Trust filed an answer and counterclaims, alleging, inter alia, bad

faith. Principal filed a motion to dismiss the counterclaims, arguing that the mere filing of a declaratory judgment action is insufficient to give rise to a claim for relief under Pennsylvania's bad faith statute. The Trust responded that the bad faith statute is not limited to cases involving the alleged wrongful denial of benefits. The court held that the Trust's allegation—that Principal acted in bad faith by seeking a declaration regarding its rights and obligations under the policies—was not sufficient to state a claim for bad faith. The court accordingly dismissed the counterclaims.

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