Saul Ewing LLP
INSURANCE PRACTICE GROUP
NOVEMBER 2010

The Bad Faith Sentinel

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

Bad Faith Insurance Newsletter Contacts:

Joseph C. Monahan
215.972.7826
jmonahan@saul.com

Thomas S. Schaufelberger
202.295.6609
tschaufelberger@saul.com

Matthew M. Haar
717.257.7508
mhaar@saul.com

Amy L. Piccola
215.972.8405
apiccola@saul.com

CONTENTS

Pennsylvania court concludes five-month investigation not unreasonable

Morrisville Pharmacy, Inc. v. Hartford Casualty Insurance Co., 2010 WL 4323202 (E.D. Pa. Oct. 29, 2010)

In August 2008, the police investigated an attempted suicide by Carol Markowitz, the owner of Morrisville Pharmacy. Ms. Markowitz was hospitalized until the end of September 2008. During that period, the pharmacy was only open for a part of August 4, but was otherwise closed. During the month of September, Ms. Markowitz's sister removed most of the pharmacy's products, including non-narcotic prescription medications and the non-medicinal products, and placed them in storage. On September 15, 2008, the attorney for Cindy Shack, the owner of the pharmacy building, wrote to Ms. Markowitz asking her to surrender the premises, remove her belongings and return her keys. Ms. Markowitz did not respond to this correspondence. Upon leaving the hospital, Ms. Markowitz attempted to use her key to enter the pharmacy and reclaim the narcotic pharmaceuticals inventory, computers, business records, security cameras, shelving, and business supplies. Because Ms. Shack had changed the locks earlier that day and secured the doors with a heavy chain, Ms. Markowitz was unable to enter the pharmacy. Ms. Markowitz reported the lock change to the police.

In November 2008, Ms. Shack's attorney again contacted Ms. Markowitz and requested that she contact him to make arrangements for the removal of the narcotics from the pharmacy. The attorney noted that Ms. Markowitz was responsible for the custody of all controlled substances left in the store. Ms. Markowitz responded with a letter of her own stating that she was no longer legally responsible for the narcotics, as she had relinquished her DEA license, and requesting that the attorney contact her to arrange for removal of the narcotics from the pharmacy. The attorney did not make arrangements for the removal, but requested more information on the proper disposition of the narcotics.

In December 2008, Ms. Markowitz filed a claim with Hartford, her insurer, alleging direct physical loss of pharmacy property. In her recorded statement to Hartford, Ms. Markowitz stated that there was a theft sometime in September, but could not identify anything that was stolen. Later in the statement Ms. Markowitz admitted that her claim was simply that Ms. Shack prevented access to files and documents in the building and alleged that this prevented her from taking an

offer for sale of the pharmacy files. Ms. Markowitz did not answer directly when asked if steps had been taken to retrieve the remaining pharmacy property from the store.

While Hartford was evaluating her claim, Ms. Markowitz filed a lawsuit against Hartford for breach of contract and bad faith. Ms. Markowitz alleged that Hartford unreasonably delayed payment on her claim, premising her argument on the duration of the investigation and on Hartford's failure to obtain statements from Ms. Shack and her husband. Hartford denied the claim after Ms. Markowitz filed the lawsuit.

The U.S. District Court for the Eastern District of Pennsylvania noted that Plaintiff cited to no case law in which a court permitted a claim for bad faith based upon a five-month investigation. The court also noted that Ms. Markowitz did not submit a proof-of-loss to Hartford until three months after filing the claim. Concluding that Hartford reasonably investigated Ms. Markowitz's claim by obtaining police reports, interviewing Ms. Markowitz, and writing letters to Ms. Markowitz to inform her that the investigation was ongoing, the court granted Hartford's motion for summary judgment and dismissed the complaint.

Connecticut court holds bad faith claim for denial of coverage cannot be predicated on conduct preceding formation of insurance contract

McNeill & Associates, LLC v. Continental Casualty Co., 2010 WL 4456975 (D. Conn. Nov. 1, 2010)

In 2006, Continental issued a legal malpractice insurance policy to McNeill & Associates for the period August 30, 2006 to August 30, 2007. The policy covered claims involving legal representation that pre-dated the policy period, but excluded claims that an insured was aware of before the issuance of the policy.

McNeill & Associates, LLC was officially formed on March 13, 2006, however, for many years prior to the formation of the LLC, McNeill and another individual, Taylor, operated as partners under the name McNeill & Associates and communicated with their clients using letterhead that listed both attorneys. This partnership ended in early 2005, although Taylor continued to rent office space from McNeill. In or around July 2005, Taylor began representing an individual who would eventually sue him for malpractice. McNeill and Taylor claim that Taylor represented this client in his individual capacity and not on behalf of McNeill & Associates, however, in communications with the client, Taylor used "McNeill & Associates" letterhead and Taylor identified himself as an employee of McNeill & Associates in his entry of appearance on behalf of the client. When the client filed his malpractice suit, he sued not only Taylor, but also McNeill & Associates.

McNeill & Associates requested that Continental defend it in the malpractice litigation. Continental, by letter dated May 29, 2007, denied this request on the ground that Taylor was aware of the risk before the policy came into effect.

McNeill & Associates filed suit against Continental claiming that the insurer violated the duty of good faith for two reasons: (1) by denying coverage when Continental had a clear duty to defend McNeill & Associates; and (2) by listing Taylor as an attorney of McNeill & Associates. As to the first point, McNeill & Associates argued that an examination of the underlying complaint required Continental to defend the firm in the malpractice suit. However, the court held that "quite the opposite [was] true," because the underlying complaint alleged that Taylor was employed by McNeill & Associates at the time of his representation of the malpractice plaintiff and that he was aware of his mistake as early as seven days before the insurance policy was issued. The court continued to explain that, even viewing the facts in the light most favorable to McNeill & Associates, no reasonable jury could find that, given the information available to it, Continental's duty to defend was clear.

McNeill & Associates also argued that Continental included Taylor's name on the insurance policy's "Attorney Schedule" in bad faith. The court held that this argument had no support in the record and "[i]n fact. . . [found] the inclusion largely irrelevant to an analysis of CCC's duty to defend." The court explained, "the duty of good faith and fair dealings arises from a contract relationship once formed and not out of conduct preceding its formation," meaning the inclusion of Taylor in the "Attorney Schedule" could not give rise to a claim of bad faith for denial of coverage. The court entered summary judgment on behalf of Continental as to McNeill & Associates' bad faith claim.

California court holds that insurer did not need to appoint *Cumis* counsel where coverage issue involved the "Business Pursuits" exclusion

Summers v. State Farm General Ins. Co., 2010 WL 4261917 (Cal. Ct. App. Oct. 29, 2010)

In 2008, "John A.J. Doe" filed a sexual abuse lawsuit against 100 Does, including the Mormon Church; the perpetrator, an adult male "spiritual advisor. . . and supervisor of the Mormon Church"; a video production company, and the perpetrator's parents. The plaintiff alleged that he was a student and parishioner of the Mormon Church and that the perpetrator sexually abused him during the period of 1990 to 1999. The acts of abuse allegedly took place "on numerous occasions, and in various locations, including on the grounds owned and operated" by the Mormon Church, the perpetrator, the perpetrator's parents and the video production company.

The perpetrator's parents, Roger and Pamela Summers, were insured under a State Farm homeowners insurance policy. State Farm informed the Summers that it would defend the action against them under a reservation of rights, explaining that coverage could be denied under the policy's business pursuits exclusion. The Summers' attorneys, after receiving State Farm's reservation of rights, wrote to State Farm demanding to be appointed as *Cumis* counsel. State Farm denied the request for appointment of *Cumis* counsel, noting that State Farm had not reserved its rights with respect to either the intentional acts exclusion or the definition of "occurrence" as contained in the policy and stated that case law showed that there was no entitlement to *Cumis* counsel based on a reservation of rights with respect to a business pursuits exclusion.

The Summers subsequently filed a bad faith action against State Farm based on the failure to provide *Cumis* counsel. The Summers argued that they were entitled to *Cumis* counsel because the plaintiff in the underlying litigation alleged both that the perpetrator "was potentially acting within the scope of the 'business pursuits' exemption and that he was not."

State Farm filed a motion for summary judgment and, in response, the Summers filed a cross-motion for summary adjudication. State Farm argued that it was not required to provide *Cumis* counsel for three reasons: (1) any conflict had to be actual, not theoretical, and there was no evidence either that the perpetrator was employed by his parents or that any liability of the Summers arose out of their business pursuits; (2) State Farm would have no incentive to argue that any liability on the part of the Summers arose out of their business pursuits, because any knowledge of abuse that the Summers acquired in the business setting would be imputed to them generally; and (3) State Farm could not control the outcome of the coverage issue since the Summers' business was being represented by separate counsel and a finding that the Summers knew of the abuse and failed to stop it would result in individual liability, even if the abuse occurred on business premises. The trial court entered summary judgment in favor of State Farm and the Summers appealed.

The appellate court, after analyzing the general underpinnings of tort liability, concluded that in order to hold the Summers liable under any of the numerous theories in the underlying complaint, there must be evidence to show that they either knew or had reason to know of the perpetrator's propensities. Pursuant to this analysis, the court concluded it was clear that retained counsel could have done nothing to show that the Summers were only liable as business owners and not in any other capacity. "The point of the matter," the court concluded, was that the interests of the Summers and State Farm were aligned and appointment of *Cumis* counsel was not required.

Oklahoma court dismisses bad faith claim of insureds who could not prove they were injured by insurer's delay and change of position during investigation

Walker v. Progressive Direct Ins. Co., 2010 WL 4286244 (D. Okla. Oct. 29, 2010)

In July 2008, the Walkers' Chevy Tahoe was stolen while they were away on vacation. The vehicle, which had been affixed with a "for sale" sign, had been parked in a public lot. The Walkers' vehicle was covered by a "comprehensive" Progressive policy at the time of the apparent theft. Ms. Walker reported the theft to Progressive and informed the company that she and her husband were in possession of both keys to the vehicle. The vehicle was soon found at an abandoned property.

In August 2008, a Progressive employee inspected the vehicle to determine if the steering column had been compromised and whether the vehicle was totaled. The employee concluded that the column was not compromised and that the vehicle could be repaired for approximately $2,300. Progressive suspected insurance fraud and turned the matter over to its Special Investigations Unit under a reservation of rights. The suspected fraud was based on insurance "red flags" including that: (a) the vehicle was for sale at the time of loss; (b) the vehicle was a "gas guzzler;" (c) the steering column was not compromised; and (d) all the keys were in the possession of the insureds. The Walkers, also in August 2008, requested a second inspection of the vehicle after receiving an estimate from an independent auto body shop for repairs totaling over $11,000. Progressive's second inspection resulted in an estimate of just over $7,000.

Ultimately, after receiving copies of the Walkers' vacation photographs, as well as the original sets of keys, Progressive ruled out fraud and agreed to pay the claim. After Progressive withdrew its reservation of rights and issued payment of $6,040.92 (the amount of the estimate minus the Walkers' $1,000 deductible), the Walkers filed a lawsuit alleging bad faith. The Walkers argued that Progressive acted in bad faith in the handling of the claim, specifically alleging that the company's investigation was "untimely" and "improper."

The district court concluded that the Walkers' claim of bad faith could not withstand summary judgment. The court noted that the Walkers "offered no explanation as to how they were damaged by the alleged unreasonable actions of Progressive" and thus could not establish a key element of their claim. The court also held that the Walkers could not use the report of Progressive's expert as evidence of bad faith because the "report was prepared in the course of [the] litigation and was not part of Progressive's investigation" so it was not relevant.

Baltimore, MD
500 East Pratt St.
Charles O. Monk, II
410.332.8668

Chesterbrook, PA
1200 Liberty Ridge Dr.
Michael S. Burg
610.251.5750

Harrisburg, PA
2 North Second St.
Eric L. Brossman
717.257.7570

Newark, NJ
One Riverfront Plaza
Stephen B. Genzer
973.286.6712

New York, NY
400 Madison Ave.
John J. Jerome
212.980.7212

Philadelphia, PA
1500 Market St.
Bruce D. Armon
215.972.7985

Princeton, NJ
750 College Rd. E
Marc A. Citron
609.452.3105

Washington, DC
2600 Virginia Ave. NW
Mark L. Gruhin
202.342.3444
Edward R. Levin
202.342.3420

Wilmington, DE
222 Delaware Avenue
Wendie C. Stabler
302.421.6865
William E. Manning
302.421.6868