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# The Bad Faith Sentinel

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

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## Eastern District of Pennsylvania: Pennsylvania Uniform Trade Practices and Consumer Protection Law Claim Barred by Economic Loss Doctrine

*Tubman v. USAA Cas. Ins. Co.*, No. 12-7121, 2013 WL 1809345 (E.D. Pa. Apr. 30, 2013)

*Eastern District of Pennsylvania held, among other things, that claims for violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law are barred by the economic loss doctrine.*

Kelly E. Tubman sustained serious injuries when she was ejected from the passenger seat after the driver crashed into a tree. She filed a claim with the driver's insurance company and received the \$15,000 limit for liability. She was also eligible to receive underinsured motorist coverage ("UIM") as an insured under her father's insurance policy with USAA Casualty Insurance Company ("USAA"). The USAA policy included \$300,000 in stacked UIM coverage for four vehicles. Tubman filed a claim with USAA, but rejected its subsequent offer as insufficient. Tubman then brought suit against USAA for breach of contract, statutory bad faith, breach of fiduciary duty, common law bad faith, and violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law (the "Consumer Protection claim"). USAA moved to dismiss the fiduciary duty, common law bad faith, and the Consumer Protection claims.

USAA argued that the breach of fiduciary duty claim should be dismissed because it does not exist in the UIM context. The mere fact that an insurer and an insured enter into an insurance contract does not automatically create a fiduciary relationship but one does arise when an insurer asserts a right under the policy to handle claims against the insured, as with third party claims. Under Pennsylvania law, UIM claims are considered a hybrid of first and third party claims in that an insured often makes a direct claim against her own insurer (first party) and the claim is adversarial because the insured seeks to maximize recovery while the insurer seeks to minimize recovery (third party). The **District Court found that in this context an insurer does not assume a fiduciary duty toward an insured for UIM claims**, and dismissed Tubman's fiduciary duty claim.

USAA also moved to dismiss Tubman's common law bad faith claim because it could not be pled as a separate action from Tubman's breach of contract claim. In Pennsylvania, an insured can bring two types of

bad faith claims against an insurer: (1) a contract claim for breach of the implied contractual duty to act in good faith, and (2) a statutory bad faith claim. An insured, however, cannot simultaneously bring a breach of contract claim and a common law breach of good faith claim because the common law claim is subsumed by the breach of contract claim. Consequently, the Court dismissed Tubman's common law bad faith claim, but allowed it to proceed under her breach of contract claim.

As to the Consumer Protection claim, Tubman argued that USAA violated Pennsylvania's Consumer Protection Law by failing to properly handle, adjust, evaluate and settle her UIM claim. USAA argued that the Consumer Protection claim was

barred by the economic loss doctrine, which prohibits plaintiffs from recovering in tort purely economic losses to which their entitlement flows only from contract. **The Court found that when the alleged deceptive conduct is clearly interwoven with the contract, and the insured seeks economic damages that flow from the contract, a Consumer Protection claim cannot be brought.** Tubman argued that her claims did not arise solely from economic loss because she suffered physical injury. The Court acknowledged Tubman's underlying injury that caused her to submit a claim to USAA was physical, but that her claims against USAA were purely economic. Accordingly, the Court dismissed the Consumer Protection claim as barred by the economic loss doctrine.

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## United States District Court of Maryland Permits Aggregation of Policies to Circumvent Requirement to Seek Administrative Remedy Before Filing Bad Faith Claim in Court

*Bierman v. United Farm Ins. Co.*, No. RDB-12-2445, 2013 WL 1897781 (D. Md. May 6, 2013)

*Maryland law requires insureds to first file a bad faith claim with the Maryland Insurance Administration, unless the action is under a commercial policy whose limit of liability exceeds \$1,000,000. In a case of first impression, the District Court found that the liability limits of policies issued to different insureds may be aggregated to meet the \$1,000,000 threshold.*

Albert J. Bierman operated King Pallet, Inc. (the "Insureds") and together they owned a building located in Essex, Maryland (the "Essex Property"). United Farm Family Insurance Company ("Farm Family") issued three policies for the Essex Property: (1) an "Inland Marine" policy with a policy limit of \$400,000 that covered wooden pallets that were stored on the Essex Property; (2) a "Contractors Advantage" policy that provided coverage for the building, with a limit of \$525,000; and (3) a "Commercial Property" policy that also covered the building on the Essex property with a limit of \$575,000. Bierman was the insured on the "Inland Marine" and "Contractors Advantage" policies and King Pallet, Inc. was the insured on the "Commercial Property" policy.

On July 17, 2009, a fire damaged the Essex Property, causing the Insureds to file claims with Farm Family. After assessing the damage, Farm Family made payments for the loss, but in amounts the insureds felt were insufficient, and accordingly brought suit in the Maryland Circuit Court for Baltimore City. Farm Family removed the action to federal district court.

The Insureds alleged, among other things, that Farm Family acted in bad faith in its assessment of their insurance claims. Farm Family moved to dismiss the bad faith claim because the Insureds had failed to exhaust their administrative remedies. Under Maryland Insurance Code Section 27-1001(d)(1), a complaint for bad faith must first be filed with the Maryland

Insurance Administration ("MIA"). The MIA then must issue a decision before an insured can petition for judicial review. An insured may circumvent the requirement to file a bad faith claim with the MIA if the action involves a claim under a commercial insurance policy where the applicable limit of liability exceeds \$1,000,000.

The Insureds noted that the aggregate liability limit of their three insurance policies with Farm Family exceeded the

\$1,000,000 threshold. The Court found no Maryland or federal law addressing whether the policy limits could be aggregated. The policies did not have any provision stating whether the limits of liability could be aggregated, which the Court found to be an ambiguity interpreted against the drafter, Farm Family. **The Court held that the limits of the three policies could be aggregated and thus, the Insureds did not have to exhaust their administrative remedy prior to bringing their bad faith claim in court.**

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## Southern District of Indiana: All parts of Insurer's Claims File is Discoverable in Bad Faith Action by Insured After Insurer Failed to Accept Policy Limits Demand and Jury Subsequently Awarded Damages Exceeding Insured's Policy Limit

*Woodruff v. American Family Mutual Insurance Co.*, No. 1:12-cv-00859-TWP-MJD, 2013 WL 1729403 (S.D. Ind. April 22, 2012)

*Southern District of Indiana holds that the attorney-client privilege and the work-product doctrine do not allow an insurer to withhold the production of claims file documents, including communications with insurance defense counsel and reserve information, when such information is relevant to, and is the subject of, a bad faith action.*

Plaintiff Randall L. Woodruff is the Trustee of the bankruptcy estate of insured Jacob Key. Dewayne Hamilton had brought suit against Key alleging that Key was negligent by waiving Hamilton through a line of stopped traffic, which resulted in an automobile collision between Hamilton and a third party. American Family Mutual Insurance Company insured Key for up to \$250,000. At mediation in early 2010, Hamilton made a policy-limits demand on Key and American Family. American Family refused to settle for Key's full policy limits and six months later a jury awarded Hamilton a \$990,000 judgment against Key. Unable to satisfy the judgment, Key filed for bankruptcy. Key's bankruptcy trustee, Woodruff, retained Hamilton's counsel to pursue a bad faith lawsuit against American Family. Key waived all of his privileges relating to the underlying case and the corresponding claims file.

Woodruff filed a motion to compel the production of claims-file documents withheld by American Family on the basis of attorney-client privilege and the work product doctrine.

The Southern District of Indiana rejected American Family's attempt to withhold communications between the insurance defense counsel it hired and paid to defend Key in the underlying case. Although Indiana law may view insurance defense counsel as having a dual attorney-client relationship, the attorney-client privilege does not protect parties to the dual relationship. The Court ruled that communications between insurance defense counsel and American Family concerning the defense of the underlying case, not communications relating to the insured's coverage (which insurance defense counsel should not discuss anyway), are discoverable in a bad faith action brought by an insured against an insurer.

The Court also rejected American Family's attempt to withhold the production of documents created by American Family's claims adjuster, an in-house attorney, on the basis of the attorney-client privilege. **The Court held that "the mere fact that [the claims adjuster has] a law degree does not render all of his communications privileged."** The Court ordered the pro-

duction of the claims adjuster's entire communications concerning the defense of the underlying case and conducted an *in camera* review of the documents to ensure that none of the documents concerned an opinion as to coverage, which would not be produced.

American Family's attempt to withhold documents based upon the work product doctrine also failed. Only documents created in anticipation of litigation by Key against American Family might be protected by the work product doctrine. Here, none of the documents withheld by American Family fell under this exemption. The Court took particular issue with American Family's attempt to talk out of both sides of its mouth, on one hand attempting to withhold documents based upon an attorney-client privilege flowing from insurance defense counsel's harmonious dual representation of the insured and the insurer, while on the other hand withholding documents created during that same time period that somehow were created in anticipation of litigation between the insured and the insurer. The Court further held that the claims file is particularly important and discoverable in a bad faith action because "the trial is the

file." Even if work product documents are in the claims file, the entire claims file may be discoverable because "the entirety of the case relates to how American Family handled the [underlying] action."

The Court also required American Family to produce information concerning its reserves, finding that the amount of the reserves is telling as to how seriously an insurer evaluates the potential for its insured's liability.

Importantly, the Court's *in camera* review of the claims file led the Court to conclude that there were sufficient facts for a bad faith action to lie against American Family. The portion of the claims file that particularly interested the Court was a communication between insurance defense counsel and the claims handler in which it was noted that they both understood that an appeal may be necessary to resolve an issue in the underlying case. The Court viewed this communication as evidence that American Family knew that an adverse result was possible or likely.

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## Pennsylvania Court Finds Insured's Allegation That Insurer Relied on Unenforceable "Concurrent Cause Exclusion" Sufficient to Withstand Motion to Dismiss

*Donahue v. State Farm Fire & Cas., No. 3:13-cv-7, 2013 WL 1969444 (M.D. Pa. May 13, 2013)*

*The Middle District of Pennsylvania found that plaintiff adequately pleaded a claim for bad faith by alleging that insurer based its denial on a concurrent causes exclusion*

In March 2011, Donahue renewed his State Farm homeowners insurance policy through his agent, Tom Burns. The policy provided coverage subject to a number of exclusions, including a water damage exclusion that removed from coverage any loss resulting from water or sewage overflow or back-up. To circumvent the water damage exclusion, Donahue purchased additional coverage from State Farm that provided cover for

"direct physical loss caused by the back-up of water or sewage."

On September 28, 2011, a back-up of sewage damaged Donahue's home and on October 11, 2011 he filed a claim with State Farm. State Farm denied coverage stating that the damage was caused, at least in part, by flood waters, a loss

excluded from coverage. On December 5, 2012 Donahue sued State Farm and Burns in Pennsylvania state court for breach of contract and bad faith denial of coverage. After removing the action to federal court, State Farm and Burns filed a motion to dismiss the bad faith claim. Donahue agreed to dismiss Burns from the case, but opposed the remainder of State Farm's motion.

In evaluating the sufficiency of a bad faith claim, Pennsylvania courts require plaintiffs to plead: (1) that the insurer lacked a

reasonable basis for denying benefits; and (2) that the insurer knew or recklessly disregarded its lack of reasonable basis. The district court determined **Donahue adequately pleaded a bad faith cause of action by alleging that State Farm based its denial on a concurrent clause exclusion, a provision that is unenforceable in Pennsylvania.** According to the court, because the allegation of a denial based on an enforceable policy provision, when read in conjunction with Donahue's factual averments, may satisfy the elements of a bad faith claim, the motion to dismiss had to be denied.

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