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Contacts:

Gregory M. Boucher
617.912.0931
gboucher@saul.com

Carolyn Due
202.295.6613
cdue@saul.com

Matthew M. Haar
717.257.7508
mhaar@saul.com

Joseph C. Monahan
215.972.7826
jmonahan@saul.com

Amy L. Piccola
215.972.8405
apiccola@saul.com

Thomas S. Schaufelberger
202.295.6609
tschaufelberger@saul.com

Saul Ewing LLP

Insurance Practice

The Bad Faith Sentinel

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

CONTENTS

California Appeals Court: Insurer Does Not Commit Bad Faith By Failing To Initiate Settlement Discussions Despite Clear Liability And The Risk Of An Excess Judgment

Paul Reid v. Mercury Insurance Company, B241154, 2013 WL 5517979 (Cal. Ct. App. Oct. 7, 2013).

California Appeals Court holds that an insurer does not commit bad faith by failing to promptly settle a clear liability claim within policy limits when a claimant does not make a settlement demand or express an interest in settlement.

On June 24, 2007, plaintiff Paul Reid's mother, Shirley Reid, suffered serious injuries in an automobile crash caused by defendant Mercury Insurance Company's ("Mercury") insured Zhi Yu Huang, who failed to stop at a red light. Mercury insured Huang with policy limits of $100,000 per person. Liability was reasonably clear almost immediately after the accident.

Approximately one month after the accident, Reid's lawyer sent a letter to Mercury advising of his representation and asking for information concerning Huang's insurance coverage. Within a week, Mercury's claims manager wrote in internal claims notes that Huang's full policy limits should be tendered as soon as Mercury received medical records and a statement from Reid. However, Reid never made a settlement demand upon Mercury.

Upon Mercury's receipt of Reid's medical records in January 2008, Mercury soon thereafter made Reid an unsolicited policy limits offer. Reid rejected Mercury's offer. After a bench trial, Reid obtained a $5.9 million judgment against Huang. Huang filed for bankruptcy and the bankruptcy trustee assigned any of Reid's claims against Mercury to Reid.

Reid alleged that Mercury committed bad faith by exposing Huang to an excess judgment as a result of its failure to promptly make a settlement offer once liability was reasonably clear. The trial court ruled against

Reid at the summary judgment stage and the appeals court affirmed.

The California Court of Appeals held that even if liability is reasonably clear and an insured is at risk of an excess judgment, an insurer has no duty to initiate settlement discussions unless a claimant makes a settlement demand, or unless the claimant expresses an interest in settlement. Here, the appeals court upheld the award of summary judgment in favor of Mercury because the plaintiff never expressed an interest in settlement and never made a settlement demand. The panel stated, however, that an insurer's duty to make a settlement offer is not contingent upon a concrete settlement demand, but that an insurer can commit bad faith if it ignores a claimant's invitation to explore a settlement.

Missouri Court of Appeals: Excess Insurer May Maintain Equitable Subrogation Claim Against Primary Insurer for Bad Faith Failure to Settle

***Scottsdale Ins. Co. v. Addison Ins. Co.*, No. WD 75963, 2013 WL 5458918 (Mo. Ct. App. Oct. 1, 2013).**

In a case of first impression, the Missouri Court of Appeals determined that an excess insurer may not bring a direct claim against a primary insurer for bad faith failure to settle, but can bring a claim through equitable subrogation.

In August 2007, an employee of Wells Trucking, Inc. ("Wells Trucking") was involved in an automobile accident with another driver, who died from the injuries he sustained in the accident. Wells Trucking had a primary liability insurance policy issued by Addison Insurance Company and United Fire & Casualty Company (together, "United Fire") and an excess policy issued by Scottsdale Insurance Company ("Scottsdale"). The United Fire policy had liability limits of $1 million. The Scottsdale policy had liability limits of $2 million, which would only apply after the United Fire policy was exhausted.

In April 2008, the decedent's family demanded the limits of the United Fire policy. United Fire rejected the demand and the family filed a wrongful death lawsuit against Wells Trucking. Thereafter, the decedent's family made two more demands for the United Fire policy limits. In August 2009, the family increased their demand to $3 million, but after mediation agreed to accept a total settlement of $2 million: $1 million in policy limits from United Fire and $1 million from the excess policy from Scottsdale. Scottsdale reserved its right to pursue United Fire for bad faith refusal to settle and also secured a written assignment from Wells Trucking of its claim. Scottsdale then filed suit against United Fire to recover the $1 million Scottsdale had paid to settle the underlying lawsuit. Among its legal theories, Scottsdale asserted that it was entitled to recover amounts it contributed toward settlement: (i) because United Fire owed Scottsdale a direct and independent duty to act in good faith to settle within the primary policy limits; (ii) through the written assignment from Wells Trucking; and (iii) based on the theory of equitable subrogation.

United Fire filed a motion for summary judgment, arguing that Scottsdale could not bring a bad faith failure to settle claim under Missouri law, and that it could not recover through the rights of Wells Trucking because all of the elements of a bad faith failure to settle claim could not be established. The trial court granted United Fire's motion for summary judgment and Scottsdale appealed.

The Missouri Court of Appeals noted that the case was one of first impression in that Missouri had not yet determined whether an excess insurer may sue a primary insurer for bad faith failure to settle within the primary policy limits. The panel determined that a primary insurer's duty to negotiate in good faith for its insured is attendant to the contractual relationship between the insured and the insurer, which, in part, is a function of what the insured is entitled to expect upon payment of a premium. However, there exists no such relationship between an excess insurer and a primary insurer. Although both the primary and excess insurers are bound to act in good faith for their insured, neither insurer is directly bound to act in good faith for the interests of the other. Accordingly,

Scottsdale's claim that United Fire owed it a duty of good faith in settlement of the underlying litigation was properly dismissed by the trial court.

The panel also noted that Missouri law was not settled as to whether a bad faith failure to settle claim could be assigned. However, the panel determined that it need not resolve the question because the damages sought by Scottsdale were not incurred by Wells Trucking. Accordingly, the assignment of Wells Trucking's right to assert a claim for bad faith failure to settle would not help Scottsdale recover its damages.

The court, however, did find that Scottsdale could maintain its claim for equitable subrogation against United Fire. Scottsdale argued that but for the excess policy, Wells Trucking would have had a claim against United Fire for bad faith failure to settle for the amount paid to resolve the underlying lawsuit that was over and above the United Fire policy limits. The panel determined that in bringing an equitable subrogation claim, the excess insurer was not enforcing a duty owed directly to it by the primary insurer, but merely sought to recover the amounts the primary insurer would have been obligated to pay its insured but for the excess insurer's performance.
The trial court concluded that even if Scottsdale could bring its claims, it could not establish two essential elements of bad faith failure to settle. First, the trial court determined that a judgment in excess of the policy limits was an "essential element" of a bad faith failure to settle claim. The appellate court, however, found that a judgment in excess of the policy limits was not an essential element; instead an excess insurer's claim of equitable subrogation premised on bad faith failure to settle required the excess insurer to establish: (1) that the primary insurer had the authority to settle a claim against its insured within the primary policy limits; (2) that the primary insurer had the opportunity to settle within the primary policy limits; (3) that the primary insurer failed to do so in bad faith; (4) that the excess insurer made a payment within the limits of its excess policy to discharge an obligation it owed its insured; and (5) that but for the excess insurer's payment, the insured would have incurred damages in the amount of the payment as a proximate result of the primary insurer's conduct.

The trial court also erroneously concluded that regardless of its "good or bad" faith, United Fire did not fail to settle within its policy limits. The panel stated that the fact that United Fire contributed its $1 million policy limits did not negate the essential element of "failing to settle within the policy limits." The appellate court held that unless the payment of the policy limits alone resolved the claim, it is axiomatic that the primary insurer failed to settle the claim within its policy limits. Accordingly, the court reversed the trial court's grant of summary judgment as to Scottsdale's equitable subrogation claim.

Sixth Circuit Holds That Insurer, Whose Interpretation Of Policy Language Was Reasonable, Did Not Act In Bad Faith Even When That Interpretation Ultimately Proved Incorrect

***Philadelphia Indem. Ins. Co. v. Youth Alive, Inc.*, Nos. 12-5759, 12-5805, 2013 WL 5583588 (6th Cir. Oct. 11, 2013).**

Insurer's coverage position, which was ultimately deemed partially incorrect, was reasonable because it was based on plausible interpretations of policy language.

In 2008, Youth Alive, a nonprofit corporation providing mentoring and other services to at-risk youth in Louisville, Kentucky, transported several youths to an event using its three vans. When the event concluded, four of the youths attempted to board a Youth Alive van for the ride home, but were apparently unable to do so because it was full. In response, a Youth Alive employee requested that sixteen year-old Herbert Lee, a Youth Alive participant who had driven himself to the event in a separate vehicle, drive the four participants home. Despite driving himself to the event, and agreeing to transport to the

other four participants, Lee did not possess a valid driver's license. Moreover, the car he was driving was not his: it had been stolen during a carjacking. Soon after departing from the event, a police officer noticed that Lee was driving erratically, ran a check of the license plate, discovered that the car was stolen, and gave chase. Lee fled from the pursuing officer, but lost control of the car and crashed into a tree. Lee survived the crash, but his four passengers were killed.

After the accident, the estates of the four passengers brought lawsuits against Youth Alive alleging that the organization was negligent in permitting the children to be driven home by Lee. Youth Alive put its insurer, Philadelphia Indemnity, on notice of the suit and requested defense and indemnification. Philadelphia Indemnity provided a defense in the state court action pursuant to a reservation of rights letter that disputed coverage.

Philadelphia Indemnity filed a declaratory judgment action in the District Court for the Western District of Kentucky seeking a judicial determination that neither of Youth Alive's policies provided coverage for the claims arising from the accident. According to Philadelphia Indemnity, the Automobile Exclusion in Youth Alive's CGL policy, which excluded coverage for any bodily injury arising from the use of any automobile owned or operated by or rented or loaned to any insured, applied because the CGL policy defined insured to include "volunteer workers" and "club members" performing activities on Youth Alive's behalf. Lee, Philadelphia Indemnity argued, was either a "volunteer worker" or "club member" and, accordingly, bodily injury resulting from his operation of the car was excluded from coverage. Philadelphia Indemnity likewise argued that its excess policy did not provide coverage for the claims because it contained an automobile liability exclusion that excluded "any liability" arising out of the use of any automobile, whether or not operated by an insured.

Youth Alive counterclaimed, asserting that Philadelphia Indemnity's coverage positions had no reasonable basis in law or fact and that Philadelphia Indemnity therefore breached its common law duty of good faith and fair dealing and violated the Kentucky Unfair Claims Settlement Practices Act by misrepresenting pertinent coverages and failing to affirm liability on claims within a reasonable time. The parties filed cross motions for summary judgment on the coverage issues and Philadelphia Indemnity filed a motion to dismiss Youth Alive's counterclaims. The district court granted in part and denied in part both parties' motions for summary judgment, concluding that Philadelphia Indemnity was obligated to defend and indemnify Youth Alive pursuant to the CGL policy, but not under the excess policy.

Meanwhile, the state court action between the estates and Youth Alive was dismissed and Youth Alive's liability to the estates was extinguished by a settlement and the payment by Philadelphia Indemnity of $1.8 million. The settlement sum represented the $1 million limit of the CGL policy plus $800,000 of the $2 million excess policy. The district court later granted Philadelphia Indemnity's motion to dismiss the counterclaims reasoning that, as a matter of law, Philadelphia Indemnity's coverage position had not been taken in bad faith. The parties cross-appealed the district court's adverse rulings.

At argument, the parties conceded that their appeals of the summary judgment rulings were moot in light of the settlement in the underlying action. As a result, only the dismissal of the bad faith claims remained pending for purposes of the appeal. The district court determined that Youth Alive failed to adequately allege that Philadelphia Indemnity lacked a reasonable basis in law or fact for contesting coverage under the policy. With respect to the CGL policy, Youth Alive pointed to its executives' and board members' opinions regarding who they believe is a "volunteer" for the purposes of the organization's operations as support for its position that the insurer was unreasonable. The district court noted that although the trial court ultimately ruled that Lee's acquiescence to the request to drive the children home from a sponsored event was neither sufficiently donative nor suitably taken within the scope of duties determined by Youth Alive to render him a "volunteer worker," Philadelphia Indemnity's argument in this regard was reasonable and may have been correct. Coverage under an insurance policy depends on the terms of the policy and Philadelphia Indemnity's reading of the policy's language was at least a plausible one; it was not unreasonable to argue that Lee, in accepting Youth Alive's directive to transport the children on its behalf, fell within the terms of the policy. The court further concluded that Philadelphia Indemnity's argument that Lee was an insured by virtue of being a club member was similarly the subject of genuine debate—Lee was a relatively active Youth Alive participant and an argument that his participation made Lee a "member" of the group, even if ultimately incorrect, was not entirely lacking in any reasonable basis. Finally, the court held that Youth Alive was incorrect in arguing that Philadelphia Indemnity had no reasonable basis to contest coverage under the excess policy given that the plain language of the policy supported the insurer's position.

District Court of Colorado: Insurer May Not Rescind Policy Where Insurance Agent Provides False Information in Insured's Application, Even if Insured Signs Application

Barrera v. American Nat'l Property and Cas. Co., No. 12-cv-00413, 2013 WL 5426349 (D. Colo. Sept. 27, 2013).

Under Colorado law, insurance agents represent the insurer and not the insured. Accordingly, an insurer may be estopped from rescinding policies if an insurance agent provides false information in an insured's application, even where an insured signs the application. Moreover, an insured may maintain a bad faith claim even if the decision to rescind a policy is fairly debatable where the insurer conducted no investigation in issuing the policy, but rescinded the policy without inquiring as to how the applications were taken by the agent.

Over the course of four years, American National Property and Casualty Company ("American National") issued fourteen insurance policies to Lidia and Telesforo Barrera, including automobile insurance policies and rental owners insurance policies. After issuance of the policies, two fires occurred in the rental home owned by the Barreras. The Barreras made claims for damages to their vehicles, loss of contents, loss of rental value and loss to the structure of the home itself.

Finding the fires to be suspicious, American National conducted a criminal background check of the Barreras. The search revealed that Mr. Barrera had been convicted of a felony before the Barreras applied for insurance.
American National took the examination under oath of Lidia Barrera, who testified that she believed that the insurance agent had filled out the insurance applications, but admitted that she had signed the applications. Mrs. Barrera also admitted that she knew the insurance company would rely on the information provided to decide whether to issue the policies. She also testified that the "yes" box should have been checked in response to the question regarding whether any member of the household had been convicted of a felony or drug possession.

American National decided to rescind all of the policies, return the policy premiums and consider the policies void ab initio based on the ground that Mrs. Barrera had knowingly misrepresented information requested in the policy applications. American National denied the Barreras' claims and issued a letter informing the Barreras that the policies had been rescinded, along with checks for the policy premiums. The Barreras filed suit against American National for breach of contract and bad faith.

Robert Edgin, the insurance agent who sold the Barreras the policies, testified in his deposition that his habit and practice was to have an initial meeting with a potential client to present proposals for insurance. If the potential client was interested, Edgin would set up a second meeting. Before the second meeting, Edgin's staff would prepare a preliminary application, using presumptive answers without asking the applicant those questions. Edgin's staff always checked the "no" box for the felony question on the preliminary application. At the second meeting, Edgin would go through the application with the applicant prior to having them sign it. However, Edgin testified that his habit and practice did not entail going through the questions and presumptive answers on a question-by-question basis. Edgin stated that had he been aware at any time that either of the Barreras had a felony or drug conviction in their past, he would not have considered them for insurance.

The Barreras asserted that at no time during the application process did Edgin or his staff ask whether any member of the Barreras' household had been convicted of a felony or drug possession. The Barreras also asserted that Edgin did not review the applications with them, and that he merely instructed Mrs. Barrera where to sign. American National disputed the Barreras' assertions and argued that by signing the applications, Mrs. Barrera indicated the information therein was true and correct. American National argued that it would not have issued the policies to the Barreras because its practice was not to issue policies to a person convicted of a felony.

American National filed a motion for summary judgment on the basis that its rescission of the policies was valid. The district court found that four of the fourteen policy applications did not contain any underwriting questions, and therefore summary judgment would not be appropriate as to those policies. As to the remaining ten policies, the conflicting testimony of the parties and Edgin demonstrated issues of fact as to whether the Barreras reviewed their applications and whether the Barreras or Edgin provided the false information in the applications. The court also noted that in the majority of jurisdictions, an insurer is estopped from rescinding a policy where its agent fills out the application without asking underwriting questions, even if the insured subsequently signs the application. Construing the facts in the light most favorable to the Barreras, the district court found that American National could be bound by the negligent or fraudulent acts of its agent, Edgin, and be estopped from rescinding the policies based on the misrepresentations in the applications. Accordingly, the court denied American National's summary judgment motion based on rescission.

American National also argued that it was entitled to summary judgment as to the Barreras' bad faith claims because its conduct was not willful, wanton, reckless or outrageous as a matter of law. American National claimed that it chose to rescind the policies only after a thorough investigation and based on coverage counsel's interpretation of *Silver v. Colorado Casualty Insurance Company*, 219 P.3d 324 (Colo. App. 2009). In *Silver*, the Colorado appellate court held that under the *"Van Fleet rule,"* an insurer is estopped from rescinding an insurance contract where an applicant gave truthful information to an insurer's agent, but the agent inserted false information into the application. However, the *Silver* court held that an insurer could rescind if the applicant gave the insurer's agent false information, or did not give any information, and the agent inserted false information. The district court acknowledged that American National's decision to rescind may have been fairly debatable based on the *Silver* case, but held that it was not dispositive of the issue of bad faith. In defending a fairly debatable claim, the insurer was still required to exercise reasonable care and good faith. In this case, there were issues of fact as to American National's conduct as the evidence could support a finding that it issued policies to the Barreras with no investigation, was paid $25,000 over five years in premiums, and then abandoned the Barreras in the face of a large claim without even contacting its agent to determine how the applications were taken. Moreover, American National rescinded four policies that did not contain any underwriting questions, and rescinded policies where the applications were illegible or incomplete. The district court thus denied summary judgment as to the bad faith claims.

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

Boston, MA
131 Dartmouth St.
Richard D. Gass
617.723.3300

Chesterbrook, PA
1200 Liberty Ridge Dr.
Michael S. Burg
610.251.5750
Nathaniel Metz
610.251.5099

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
555 Fifth Ave.,
Michael S. Gugig
212.980.7200

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

Pittsburgh, PA
One PPG Place
Charles Kelly
412.209.2532
David R. Berk
412.209.2511

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

Washington, DC
1919 Pennsylvania Ave, NW
Mark L. Gruhin
202.342.3444
Andrew F. Palmieri
202.295.6674

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