JULY 2014

Contacts:

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

Matthew J. Antonelli
202.295.6608
mantonelli@saul.com

A.J. Kornblith
202.295.6619
akornblith@saul.com

Patrick F. Nugent
215.972.7134
pnugent@saul.com

Meghan Talbot
215.972.1970
mtalbot@saul.com

Gina Russoniello
grussoniello@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

Eleventh Circuit: Excess Insurer, Like All Florida Bad Faith Claimants, Must Prove Causation to Succeed on Bad Faith Claim Against Primary Insurer

Westchester Fire Insurance Co. v. Mid-Continent Casualty Co., No. 13-12932, 2014 WL 2766764 (11th Cir. Jun. 19, 2014)

The Eleventh Circuit finds that a primary insurer did not act in bad faith by failing to inform excess insurer of a post-verdict settlement offer when the excess insurer could not prove that it would have accepted the settlement offer.

Jesus Pillado sued Continental Manufacturing Inc. for products liability claiming that he suffered several injuries, including brain damage and fractured vertebrae, while operating one of Continental's concrete mixer trucks. Continental tendered the suit to its insurers, Mid-Continent Casualty Co. (the primary insurer) and Westchester Fire Insurance Co. (the excess insurer).

Mid-Continent agreed to provide a defense to Continental. From the beginning of the litigation, Westchester demanded that Mid-Continent settle Pillado's suit. Despite several attempts to settle, Mid-Continent was unable to settle the suit because Pillado's lowest settlement demand of $1 million was significantly above Mid-Continent's settlement range of $150,000 to $350,000.

The case proceeded to trial and, on June 30, 2010, the jury returned a $1.7 million verdict in favor of Pillado. About two weeks later, Pillado offered to settle for $1.6 million. Mid-Continent, believing that the net award would not exceed $1.6 million due to a setoff from a workers' compensation lien, declined to settle. Mid-Continent did not inform Westchester of Pillado's offer before declining.

Contrary to Mid-Continent's prediction, the trial court declined to permit a setoff for the workers' compensation lien and also awarded Pillado $285,000 in costs. The final judgment in the case was $1.9 million. Westchester ultimately incurred an excess exposure of $705,173.

On May 9, 2012, Westchester sued Mid-Continent alleging that Mid-Continent acted in bad faith when it refused to settle Pillado's claim both before and after the verdict was entered. After a two-day bench trial, the district court found that Mid-Continent's pre-verdict actions did not constitute bad faith, but that its failure to notify Westchester of the post-verdict settlement offer did constitute bad faith. The district court awarded Westchester damages of $390,173, representing the difference between what Westchester would have paid under the $1.6 million settlement and the final judgment.

Mid-Continent and Westchester both appealed. Mid-Continent contended that the trial court erred by: (1) allowing Westchester to amend the pleadings to conform to evidence of post-verdict bad faith presented at trial; (2) finding that Mid-Continent acted in bad faith post-verdict; and (3) awarding damages without finding causation. On cross appeal, Westchester contended that the district court erred in finding that Mid-Continent did not act in bad faith before and during the trial.

The Eleventh Circuit Court of Appeals first found that the district court did not err by finding that Mid-Continent did not act in bad faith before and during the trial. Westchester had argued that Mid-Continent should have offered more money to settle the case and should have made offers earlier in the proceedings. The court rejected Westchester's arguments and upheld the district court's holding, explaining that Mid-Continent did not act in bad faith because it had reasonably calculated and offered settlement amounts based on the results of two mock trials and defense counsel's estimations.

In support of its appeal, Mid-Continent argued that Westchester presented no evidence that it would have accepted the post-verdict settlement even if it had been informed of the offer. The Eleventh Circuit, recognizing the lack of proof, held that the district court erred by awarding Westchester damages without any proof of causation and reversed the judgment against Mid-Continent. The court explained that under Florida law, a valid bad faith claim must show a "causal connection between the damages claimed and the insurer's bad faith." The court rejected Westchester's argument that its pre-verdict requests for settlement were sufficient proof that it would have accepted the post-verdict settlement. Because the court reversed on this basis, it did not address Mid-Continent's other arguments.

Northern District of Alabama: No Bad Faith Where Insured Made Misrepresentations in Court Filings and Insurer Reasonably Relied on Advice of Counsel in Denying Coverage

***Malone v. Allstate Indemnity Co.*, No. 2:13–CV–00884–WMA, WL 2592352 (N.D. Al. Jun. 10, 2014)**

The Northern District of Alabama finds that an insurer did not act in bad faith by denying coverage for damage caused by a house fire where investigators suspected arson, the insured made misrepresentations in bankruptcy filings, and the insurer received an uncontradicted coverage opinion from an attorney.

On March 28, 2011, Sherry Malone's house suffered fired damage. Malone made a claim for the damage under her Allstate homeowner's policy. Despite having lived in the home for over seven months, Malone had obtained the policy just days after receiving a job offer that required her to move to a different state and only a few weeks prior to the fire.

Allstate refused to pay the insurance benefits, and Malone sued for breach of contract and bad faith and/or wanton denial of insurance benefits. Allstate in turn sought summary judgment on both of those counts. When Malone failed to file a timely response to Allstate's motion, thereby not disputing the material facts that Allstate set forth, the court granted judgment for Allstate on both counts.

The court explained that to prevail on a claim of bad faith denial of benefits in Alabama the plaintiff must show that the insurer either acted with intent to injure or had no legitimately

debatable reason to deny the claim. In this case, the court said, Allstate had three debatable reasons to deny the claim: (1) evidence of arson; (2) evidence of a misrepresentation by Malone; and (3) the advice of counsel.

In Alabama, a prima facie case of arson requires evidence of "arson by someone," "motive by the insured," and "unexplained surrounding circumstantial evidence implicating the insured." First, gasoline was found in the area where the fire originated and where no gasoline was normally stored, establishing "arson by someone." Second, because Malone was suffering from financial difficulties and had filed for bankruptcy, recently obtained a new job for which she planned to move out of state, and purchased the insurance policy only weeks prior to the fire, there was sufficient evidence of "motive by the insured." Finally, an informant had contacted Allstate claiming that Malone had told him that she intended to recoup the $60,000 policy limit by having a fire started in her basement.

Allstate also presented evidence that Malone misrepresented a material fact when making her claim. Malone claimed over $82,000 in personal property as of the date of the fire, despite having claimed that she owned only $1,132 worth of non-vehicle personal property in a bankruptcy filing made the year before. The court explained that despite the fact that Malone may have received a moderate salary increase since the date of the bankruptcy filing, Allstate had legitimate grounds to doubt that she could have bought an additional $70,000-$80,000 worth of personal property during that time. The court rejected Malone's argument, made to an Allstate investigator, that she had failed to read the bankruptcy petition before it was filed and that it contained inaccurate information, finding that her failure to read or later amend the petition constituted sufficient circumstantial evidence that she misrepresented the amount of personal property she lost in the fire.

Finally, the court explained that relying on private counsel's advice can bolster an insurer's argument that it did not act in bad faith and that it had a debatable reason to deny benefits. Allstate relied on the advice of a private lawyer who had submitted a coverage opinion. Because there was no evidence on the record that contradicted the coverage opinion, the court found that Allstate was entitled to rely on the coverage opinion. This reliance on the informed advice of private counsel, according to the court, further showed a lack of bad faith.

Western District of Texas: An Expert Must Base a Determination of Bad Faith on the Facts Available to the Insurer When it Acted

***Falcon v. State Farm Lloyds*, No. 1:12-CV-491-DAE, 2014 WL 2711849 (W.D. Tex. June 16, 2014)**

The Western District of Texas finds that a policyholder's expert witness is not qualified to opine when he does not sufficiently examine the facts available to the insurer, and when the expert is not able to define good or bad faith.

In September 2011, a wildfire occurred in Bastrop County, Texas, where Andrew and Donna Falcon lived. The Falcons were evacuated from their home. On September 6, 2011 they contacted State Farm, their homeowners insurer, stating they believed their home had been destroyed. State Farm issued a $5,000 advance to assist them while they were barred from their home.

Although the fire did not cause significant physical damage to the property, the Falcons filed a claim seeking to recover under the policy for damage caused by exposure to the fire's smoke. On September 9, 2011, State Farm assigned Vidale Coleman, a catastrophe claims adjuster, to evaluate the claim. Coleman drove to the property on September 12, 2011 and found it still standing.

He returned for further inspection on September 16, 2011. According to State Farm, Coleman did not find any direct fire damage to the roof or exterior of the house, but he did find minor fire damage on the deck and damage to the trees and lights in the yard. Coleman allotted for the payment of the expense of cleaning the interior and exterior of the residence by a company called Service Master and for food loss. When Donna Falcon asked about smoke damage to the carpet,

Coleman informed her that she would first need to attempt to clean it before State Farm would authorize replacement. Donna Falcon also asked whether State Farm would replace one of the refrigerators in the home, which she claimed smelled from rotting food remaining inside after the power went out. State Farm ultimately denied coverage for the refrigerator because the damage was not a "covered peril."

On September 26, 2011 Coleman prepared an estimate allowing for (1) $8,245 for the trees, shrubs, and other plants in the yard; and (2) $8,395.12 for remediation of the house, including cleaning and repairs. State Farm issued a check to the Falcons for $11,643.12 for the total, less the $5,000 advance. State Farm issued an additional check for $1,505.94 to cover the Falcons' alternative living expenses, food loss, and damage to personal property. On October 7, 2011, Coleman issued a new statement of loss that included an additional $991.90 in forced evacuation expenses and $114.78 to clean the Falcons' personal property. State Farm ultimately paid another $2,037 in living expenses and forced evacuation expenses.

Donna Falcon later contacted State Farm claiming that she did not have the money to pay Service Master for the cleaning and that she believed State Farm should be responsible for the bill. State Farm informed her that it had already issued payment for this expense and that it was the Falcons' responsibility to pay the bill.

Subsequently, the Falcons' attorney sent State Farm a letter seeking full payment of the claim and attaching an estimate from Stephen Hadhazi, a public adjuster, claiming the Falcons were entitled to a payment of $112,766.59 to remediate the property entirely.

On May 7, 2012, the Falcons filed suit against State Farm contending that State Farm failed to properly investigate their insurance claims as required by the policy. The Falcons brought six claims against State Farm, including a claim that State Farm violated its duty of good faith and fair dealing. The Falcons identified Hadhazi as their expert on bad faith.

State Farm moved to strike the expert testimony of Stephen Hadhazi, arguing that Hadhazi's opinion should be excluded because: (1) it was based only on the fact that his estimate differed from State Farm's estimate; (2) it was unreliable because he did not review any of the claims file, the Service Master estimate for remediation, or the depositions of State Farm's agents or the Falcons' depositions; and (3) Hadhazi could not properly define good or bad faith.

In response, the Falcons argued that Hadhazi's licensing as a public adjuster was sufficient to qualify him to assess the "physical loss of or damage to structural or personal property, and structural or personal property values."

The court agreed with the Falcons that Hadhazi's licensing as public adjuster qualified him in the area of public adjusting. The court explained, however, that he was not engaged as a public adjuster in this case, but was engaged to provide an independent consultation to the Falcons. Thus, the court held that his experience was not enough to render his testimony reliable when all his opinions were based on "guesswork."

The court agreed with State Farm that Hadhazi's failure to speak with anyone at State Farm; failure to review the claim file; failure to review the deposition transcripts; and failure to review the Service Master cleaning estimate established that he could have no basis for understanding the facts available to State Farm. Thus, he was not able to properly opine on State Farm's alleged bad faith.

Finally, in light of Hadhazi's inability to define good faith or bad faith, the court concluded that a jury was just as competent to read a statutory definition from the Texas Insurance Code, and that Hadhazi's opinion was irrelevant and not helpful.

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.
Joel C. Hopkins
717.257.7525

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
650 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