JULY 2013

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

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Northern District of Texas: No Bad Faith for Denying Property Damage Claim Due to Insured's Failure to Allow Insurer More Than a Day's Time for Inspection Prior to Insured's Remediation

Mario Santacruz v. Allstate Texas Lloyds, Inc.., No. 3:12-CV-02553, 2013 WL 3196535 (N.D. Tex. June 25, 2013)

Northern District of Texas holds that despite an insured's legitimate belief that his roof required immediate remediation, an insurer does not commit bad faith by denying a claim and not conducting an inspection within 24 hours of notification.

Plaintiff Mario Santacruz's home was insured by defendant Allstate Texas Lloyds, Inc. when a storm blew shingles off Santacruz's roof. Santacruz's home suffered water and other interior damage from portions of his roof falling into his home. Santacruz covered his roof with a tarp and a contractor recommended that he immediately fix his roof. The next day, Santacruz called Allstate and requested an inspection by Allstate that same day because workers were on-site ready to commence remediation. After Allstate advised Santacruz that it could not send an inspector for a couple of days, Santacruz proceeded with the remediation work before Allstate could inspect the roof and damages. Allstate arrived at Santacruz's home two days later, at which time all of the remediation work was completed.

Allstate denied Santacruz's claim on the basis that it was unable to investigate his loss. Allstate argued that its denial was reasonable because "(1) [Allstate] could not investigate the claim to assess whether it fell within the coverage afforded under the policy, and (2) Plaintiff has not properly established his right to coverage by showing both that the loss was a covered incident and the extent of his damages."

Santacruz asserted that liability was clear based upon his own affidavit and an affidavit from his roofer. The roofer's affidavit stated that wind blew shingles off Santacruz's roof, rain entered the home due to missing shingles and damaged the interior of the home, and immediate remediation was required due to an

imminent rainstorm. Santacruz's affidavit attempted to certify his damages by stating that Allstate's adjuster viewed that his home's collapsed ceiling was caused by water penetration from the roof, and further stated that his home had no prior history of roof or water damages.

The court held that Allstate reasonably denied Santacruz's claim and therefore did not commit bad faith. First, it was not reasonably clear that Santacruz's claim was covered. Santacruz did not provide sufficient information to prove that the roof defect was caused by wind-blown shingles, as opposed to another cause. (The affidavit from his roofer was not sufficient because it did not state a basis for his roofer's belief.) Second, Santacruz did not provide Allstate with a reasonable opportunity to investigate the cause of Santacruz's claim; when Allstate arrived at Santacruz's home, it was impossible to conduct a causation and damages investigation due to the installation of a new roof.

District of South Carolina: Insurer Files Suit to Determine if Insured has a Common Law Marriage That Would Afford Additional Insurance Benefits; Court Permits Broad Discovery Into Insurer's Policies and Procedures After Insured Alleges Bad Faith

Motsinger v. National Mutual Insurance Company, No. 4:11-cv-01734-JMC, 2013 WL 3338497 (D.S.C. July 2, 2013)

District of South Carolina issues broad discovery ruling holding that an insurer's employee bonus structure, training manuals, legal expenses, bad faith claims history and internal policies all are discoverable.

Plaintiff Carlotta Motsinger and Nationwide Mutual Insurance Company are involved in several lawsuits concerning their dispute as to whether Motsinger may recover additional insurance benefits as a result of her alleged common law marriage with William Workman. Motsinger is attempting to "stack" insurance coverage under her Nationwide policies by alleging a common law marriage with Workman. Nationwide filed a declaratory action to determine if Motsinger and Workman were in fact involved in a common law marriage.

Motsinger alleges that Nationwide's inquiry into her common law marriage was made in bad faith to deny her claims. In support of her bad faith claims against Nationwide, Motsinger sought broad discovery into Nationwide's claims practices.

Largely ruling in Mostinger's favor on her motion to compel discovery from Nationwide, the court allowed the following discovery into Nationwide's policies, practices, and procedures:

- Information concerning all bad faith cases involving automobiles in South Carolina over the past two (2) years;
- Information concerning bonus or incentive programs for Nationwide's claims employees;
- The amount of money paid to employees for incentives achieved for work on Motsinger's case;
- Nationwide's training and instructional manuals in effect during Motsinger's claim;
- Nationwide's litigation process and protocols in effect during Motsinger's claim; and
- An accounting of Nationwide's legal expenses prior to Motsinger's bad faith action.

The court's ruling serves as a reminder that insurers' claim departments can become an open book once a bad faith claim is asserted.

Supreme Court of Appeals of West Virginia: Third-Party Bad Faith Claims are Not Permitted Based on Processing of a Claim

Triad Insulation, Inc. v. Nationwide Mut. Fire. Ins. Co., No. 12-1110, 2013 WL 3184656 (W. Va. June 24, 2013).

The Supreme Court of Appeals of West Virginia affirmed the trial court's dismissal of a third-party claim for bad faith based on processing of a claim for damages to personal property located in a building that allegedly was demolished because of the insurer's failure to promptly repair the building.

Triad Insulation, Inc. ("Triad") used a building located in Huntington, West Virginia as its principal place of business. Brian Galligan was the sole owner of Triad and the building was owned by Mr. Galligan's wife, Helen Galligan. Triad obtained a commercial property insurance policy issued by Nationwide Mutual Fire Insurance Company ("Nationwide") to cover direct physical loss or damage to the building. On January 6, 2010, the building suffered structural damage to its roof due to large quantities of snow and ice buildup. Triad reported the structural damage claim to Nationwide, which assumed control over all matters related to the loss, including determining the extent of repairs needed for the building. The building, however, was a total loss and was demolished in March 2010. Triad and Brian Galligan brought suit against Nationwide, alleging that Nationwide's failure to authorize necessary repairs in a reasonable and timely manner resulted in the total loss of the building.

Nationwide filed a motion to dismiss count five of the complaint for the loss of Galligan's personal property stored in the building. Galligan labeled count five as a claim for "negligence." However, Nationwide argued that the claim was a prohibited third-party bad faith claim because Galligan was not an insured under the policy and was attempting to recover for Nationwide's alleged bad faith handling of the claim. The trial court agreed with Nationwide and granted the motion to dismiss. The trial court also denied Galligan's motion to amend the complaint to add his wife as a plaintiff as she was also not an insured under the policy. Triad and Galligan appealed.

On appeal, Triad and Galligan contended that Galligan's claim was not a third-party bad faith action because he was not an adversary of Triad. Nationwide argued that Galligan, as a third party to the policy, could not sue Nationwide in tort for duties defined by the contract of insurance. Moreover, Nationwide stated that Triad still had a pending bad faith claim against Nationwide, despite the fact that Triad had already been paid the full policy limits, in excess of $300,000 on a policy that covered a property purchased in 1996 for $150,000. The appellate court noted that in West Virginia, a third party to an insurance contract has no common law tort cause of action for a breach of the duty of good faith and fair dealing arising out of the insurance contract. Accordingly, the panel affirmed the dismissal of Galligan's third-party bad faith claim.

Louisiana Court Finds That Where Doubt Existed as to Coverage Under Excess Policy, Insurer's Decision to Withhold a Defense Was Not Bad Faith

XL Specialty Ins. Co. v. Bollinger Shipyards Inc., et al, 2:12-cv-02071, —- F. Supp. 2d ——, 2013 WL 3216105 (E.D. La. Jun. 24, 2013)

District Court for the District of Louisiana determines that excess policy did not require defense or indemnification until the primary policy was exhausted and that even if it did, the insurer would not have acted in bad faith in withholding a defense.

In 2011, the United States sued Bollinger Shipyards in connection with Bollinger's work on the United States Coast Guard's Deepwater program, which involved the replacement of the Coast Guard's fleet of water vessels, aircraft and electronic

systems. Bollinger had been engaged to convert eight Coast Guard patrol boats from 110-feet to 123-feet. The government's complaint included claims for violation of the False Claims Act (FCA), common law fraud, negligent misrepresentation and unjust enrichment premised on allegations that Bollinger knowingly manipulated certain structural calculations regarding the strength of the hulls of patrol boats in order to induce the Coast Guard to proceed with its plan. On January 30, 2013, the court dismissed the complaint, granting the United States leave to amend its FCA and fraud claims. The United States filed a motion to reconsider and Bollinger filed a motion to dismiss the Amended Complaint. Both motions are still pending.

From 2000 to 2008, Bollinger carried primary general liability insurance provided by XL Specialty. From 2000 to 2004 and 2009 to 2010, Bollinger also carried excess general liability coverage provided by Continental. In July 2011, Bollinger placed Continental and its other insurers on notice of the government's claims against it. Continental issued a reservation of rights letter to Bollinger in August 2011, notifying Bollinger that it believed it was premature to ask Continental to provide a defense to Bollinger since the primary limit of $26 million had not been exhausted. Continental further explained that it could not take a coverage position until the position of Bollinger's primary carrier, XL Specialty, was known.

XL Specialty filed suit in August 2012 seeking a declaration as to whether its policies afforded coverage to Bollinger for the allegations made by the United States. Bollinger, in turn, sued XL Specialty and Continental seeking coverage and bad faith damages. Bollinger's petition alleged that Continental was liable to cover certain claims that exceeded the insurance limits of primary carriers. Bollinger's suit was consolidated with the suit initiated by XL Specialty.

The district court, noting that the primary insurers had not yet made any payments and that there had been no finding of liability against Bollinger in the suit by the United States, concluded that Continental had no duty to indemnify claims against Bollinger. The court further concluded that the only issues before it were whether Continental owed Bollinger a duty to defend and, if so, whether its failure to defend was arbitrary and capricious so as to warrant bad faith damages under the Louisiana statute.

The court, after examining the language of the Continental policy, concluded that Continental did not have a duty to defend when the primary policy had not been exhausted. The court went on to explain that even if Continental had been required to pay Bollinger's defense, a finding of bad faith would have been inappropriate because Continental reasonably believed that the primary layer of insurance had not been exhausted and that it consequently did not owe a duty to defend. Louisiana courts have consistently declined to find bad faith when doubt exists as to whether the plaintiff was covered under the policy at issue. The court thus held that, based on the policy terms, Continental reasonably believed that to the extent its policies covered the government's lawsuit against Bollinger, the primary layer of insurance had not been exhausted so that Continental did not act arbitrarily and capriciously in withholding payment for Bollinger's defense.

Middle District of Florida: Third-Party Bad Faith Claim Permitted to Continue Where Excess Judgment Satisfied

Tanaka v. GEICO General Ins. Co., No. 6:11-cv-2002-Orl-31KRS, 2013 WL 3701219 (M.D. Fla. July 12, 2013).

The Middle District of Florida allowed a third-party bad faith claim to continue past a motion for summary judgment where the excess judgment had been satisfied because the insured's rights were assigned at the same time as the satisfaction of the judgment.

Shayna Wardlow rear-ended Lorinda Tanaka's vehicle while it was stopped at a traffic light, injuring Tanaka. Wardlow had an automobile insurance policy with GEICO General Insurance Company ("GEICO") with a policy limit of $10,000. Tanaka's attorney sent a third-party demand letter to GEICO seeking the policy limit and informed GEICO that Tanaka was scheduled to undergo surgery for her injuries. GEICO offered to settle the claim for $2,009 and requested additional information regard-

ing Tanaka's surgery. The parties, however, failed to reach a settlement and Tanaka filed suit against Wardlow.

GEICO defended Wardlow, but final judgment was entered in favor of Tanaka in the amount of $56,124.57. Following the judgment, Tanaka and Wardlow entered into a release, wherein Tanaka simultaneously released Wardlow and was assigned Wardlow's rights against GEICO. Thereafter, Tanaka sued GEICO for bad faith and breach of contract. GEICO moved for summary judgment.

In Florida, a third party may bring a common law bad faith action directly against an insurer to recover the amount of an excess judgment. GEICO argued that where an excess judgment is satisfied, a third party cannot maintain an action for a breach of duty between an insurer and its insured. The court acknowledged that generally GEICO's argument was true, however it noted that the action could continue where there was a prior or simultaneous assignment of rights to bring an action. Moreover, the intent of the parties controlled interpretations of their releases. The agreement between Tanaka and Wardlow stated that neither intended to, in any way, release GEICO.

GEICO also argued that Wardlow believed GEICO had acted in good faith and Tanaka had not provided GEICO a meaningful opportunity to settle. However, the district court found that those arguments were based on disputed issues of material fact and thus denied GEICO's motion for summary judgment.

Tenth Circuit: Insurer Must Defend if Facts Beyond the Complaint Reveal the Mere Possibility that a Claim is Covered

***Automax Hyundai South, L.L.C. v. Zurich American Ins. Co.*, No. 12-6161, 2013 WL 3198603 (10th Cir. June 26, 2013).**

In Oklahoma, an insurer has the duty to investigate once a defense is requested and if the investigation reveals facts that suggest the possibility that a claim is covered, a defense must be provided. The failure to undertake such an investigation may constitute bad faith.

In August 2007, Tammy Moses purchased a car that was advertised as new from Automax Hyundai South, L.L.C. ("Automax") and asked her father, David Moses, to co-sign the loan. Unknown to both of them, David was the sole signatory on the loan. Approximately a month after the purchase, Tammy noticed that the car's steering wheel began to shake and two months after the purchase, Tammy claimed that the car veered dramatically while she was driving causing her to drive off the road. Following the accident, Tammy discovered that the car had extensive damage to the underbody and had previously been sold to a customer who returned the car after being unable to secure financing. David requested that Automax compensate for the underbody damage to the car, claiming that the damage predated the car's sale to the Moseses. Thereafter, David sought to rescind the sale, alleging that Automax had not fully disclosed the financing terms and defrauded him by not disclosing the prior damage.

Automax had an automotive business policy issued by Universal Underwriters Insurance Company, whose parent company is Zurich American Insurance Co. ("Zurich"). The policy provided coverage for up to $500,000 for an "occurrence" arising out of "garage operations" or "auto hazard." "Occurrence" was defined in the policy as "an accident" which results in an injury neither intended nor expected from the standpoint of a reasonably prudent person. "Injury" was defined to include "mental anguish," "mental injury," and "humiliation." The policy also provided $25,000 of coverage for statutory errors and omissions, that covered suits related to, among other things, violations of truth-in-lending laws and auto damage disclosure laws. The policy also excluded coverage for injuries caused by "dishonest, fraudulent or criminal acts."

Zurich denied coverage of the Moses' claim, stating that the damage to the car occurred after they took possession of the vehicle. The Moseses filed suit in Oklahoma state court alleging fraud, violation of the Truth-in-Lending Act, violations of Oklahoma's consumer protection statutes, and negligence or predatory lending.

Zurich provided a defense for Automax under the statutory errors and omissions provision of its policy, and coverage thereunder maxed out ten months before trial. Zurich stopped paying Automax's counsel and Automax continued at its own expense. The jury returned a verdict for the Moseses on their claims of fraud, negligence and the Truth-in-Lending Act and awarded compensatory damages of $300,000 and punitive damages of $100,000. Automax settled with the Moseses for $300,000 and then requested that Zurich indemnify it for the cost of the settlement. Zurich, however, refused to indemnify Automax, arguing that the jury's finding of intentional conduct placed the settlement outside the policy's coverage. Automax then filed suit against Zurich, alleging breach of contract and breach of the covenant of good faith and fair dealing.

Automax argued that Zurich was obligated to provide a defense because there were facts raising the possibility that the claim arose from a covered accident. Zurich, however, contended that the intentional sale of a used car as "new" could not be considered an accident.

Under Oklahoma law, an insurer has a duty to defend an insured whenever there are facts which give rise to the potential of liability under the policy. The focus is on the facts of the incident and is not limited to the allegations in the complaint. The insurer bears the burden of investigating the underlying facts and determining whether those facts trigger coverage. The policy provided "occurrence" coverage for an "accident," which could include negligent conduct that, although voluntary, produces an unexpected result. The Circuit Court, however, noted that where the voluntary action results in a foreseeable injury, there was no "accident."

Automax asserted that the sale of the car with undisclosed damage could constitute a covered accident because the underlying lawsuit contemplated that Automax did not know of the damage when the car was sold to the Moseses. The panel agreed that the failure to detect damage in the car could constitute an "accident" under the policy because the dealership would neither expect nor intend to cause injury to its customer when it resold a car it believed was not damaged. Zurich's letter denying the Moseses claim, acknowledged that it was aware that Automax may not have known of the damage when the vehicle was sold. In its letter, Zurich claimed that its investigation revealed no negligence on the part of Automax and that when the car was in for service after the date it was sold, there was no damage to the underbody of the car. Because part of the claim may have been covered by the policy, Zurich had a duty to defend all of the claims. Thus, the Circuit held that Zurich was liable for Automax's defense costs.

As to the bad faith claim, the panel suggested that Zurich may not have had a reasonable basis for denying payment and that Zurich may not have understood its duty to defend or investigate. Once a defense is requested, the insurer has a duty to investigate and must defend if the facts reveal a "mere possibility that a claim is covered." To the extent that Zurich did not conduct an investigation, it may not have had a reasonable basis for denying or delaying payment. Accordingly, the court held that summary judgment was not appropriate on the bad faith claim.

The court also held that Zurich had a duty to indemnify at least part, and possibly all, of the $300,000 settlement. The jury's verdict did not apportion the $300,000 damages award among the three theories, nor specified the precise conduct to which its finding of intentionality applied. Thus, the panel concluded it was possible that covered conduct formed part of the basis for the jury's verdict. Where both covered and noncovered causes of action are alleged, the insurer must request a special verdict to determine its indemnification obligations to its insured. Damages are presumed to be covered unless the insurer can demonstrate appropriate allocation. Although it acknowledged the difficulty that Zurich might have in apportioning its indemnity obligation, the court nevertheless permitted Zurich to have the opportunity to try to satisfy its burden and remanded the case to the district court.

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