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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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United States Court of Appeals for the Fourth Circuit: An Absence of Ascertainable Damages Does Not Preclude an Award of Punitive Damages for Bad Faith

Liberty Mut. Fire Ins. Co. v. JT Walker Indus., Inc., Nos. 12-2256, 12-2350, 2014 WL 504086 (4th Cir. Feb. 10, 2014).

The Fourth Circuit permitted recovery of punitive damages for bad faith despite insured's inability to prove actual or consequential damages, where the insurer's settlement of underlying claims was found to be willful, wanton, or reckless.

MI Windows & Doors, Inc., a subsidiary of J.T. Walker Industries, Inc. (collectively, "MI") manufactures windows and doors. MI, alongside other contractors and developers, was named as a defendant in five property damage lawsuits alleging that defective manufacturing and installation of MI windows and doors led to progressive water damage in five condominium developments.

Liberty Mutual Fire Insurance Company ("Liberty") insured MI under six commercial general liability policies, each of which had a \$500,000 deductible. When MI tendered the defense of the suits to Liberty, Liberty agreed to defend MI and retained counsel to represent it in each of the five lawsuits. MI expressed to Liberty that it did not wish to settle the cases and instead desired to proceed to trial in order to defend the reputation of its products. Despite MI's objection, Liberty settled each of the five lawsuits. Because each claim settled for no more than \$500,000, Liberty sought reimbursement from MI for the full settlement amounts in accordance with the deductible under the Policies. When MI refused to reimburse the requested settlement amounts, Liberty filed suit in the United States District Court for the District of South Carolina. Liberty sought declaratory relief concerning its right to refuse and control settlement, as well as damages for breach of contract. MI countersued, alleging breach of contract and bad faith.

The district court, despite holding that Liberty retained sole discretion to settle the underlying cases and that MI consequently lacked authority to approve the settlements, denied Liberty's motion for summary judgment with respect to MI's bad faith claim. The court denied the motion for two reasons. First, the

court held that MI's inability to approve of settlements did not preclude a finding that Liberty acted in bad faith in settling the claims. Second, the court held that the settlement amounts provided sufficient evidence for MI to take its bad faith claim to a jury.

At trial, MI offered evidence that Liberty failed to disclose certain portions of settlement discussions, including the timing of two of the settlements, and that Liberty's claims expert had failed to closely review the reserves for each case. The jury returned a verdict in favor of both parties. It ruled in Liberty's favor on its breach of contract claim, holding MI liable for the amount billed by Liberty to MI for the five settlements. On MI's bad faith claim, the jury ruled in MI's favor, finding Liberty liable for \$684,416.01 in consequential damages and awarding MI \$12.5 million in bad faith punitive damages.

The district court granted Liberty's motion for judgment notwithstanding the verdict (JNOV) on the grounds that MI failed to prove actual or consequential damages flowing from any bad faith, and therefore was not entitled to punitive damages. The court reasoned that MI failed to prove that absent bad faith, MI would have spent less than the settlement amounts on defense costs and potential damages. The court also denied MI's request for attorney's fees.

On appeal, the United States Court of Appeals for the Fourth Circuit affirmed the district court's ruling that MI failed to prove

direct or indirect damages. The appellate court reasoned that without any evidence of what MI would have spent on trial and on potential liability, the jury lacked a legally sufficient basis for determining the amount of actual damages caused by Liberty's alleged bad faith actions. The jury's verdict, in essence, rejected the possibility of MI incurring any defense costs.

Despite affirming the district court's ruling regarding MI's failure to prove damages, the appellate court reversed its ruling that absent such damages, MI could not receive punitive damages. Rather, the court held that an absence of ascertainable damages does not preclude punitive damages. The Fourth Circuit remanded and instructed the district court to determine whether the evidence supported the jury's finding that Liberty acted "willfully, wantonly, or recklessly" in settling the underlying claims. If the district court finds such evidence, the court will have to consider whether punitive damages are appropriate and whether the jury's verdict was excessive.

The appellate court further held that MI was not entitled to attorney's fees because South Carolina courts have never awarded attorney's fees as consequential damages in bad faith tort actions. MI was also not entitled to attorney's fees under a South Carolina statute that provides for an award of fees where an insurer refuses to defend or pay a claim without reasonable cause. Liberty's settlements, while they may have been in bad faith, did not equate to a failure to defend or refusal to pay.

Northern District of Alabama: Insurer Properly Investigated Claim of Damage to Mobile Home By Having Multiple Adjusters Inspect Damage and a Licensed Professional Engineer Determine Cause

Cofield v. Allstate Indem. Co., No. 1:12-cv-02100-HGD, 2014 WL 310447 (N.D. Ala. Jan. 28, 2014).

Northern District of Alabama finds no bad faith where insurer employed multiple adjusters and a Licensed Professional Engineer to investigate claim of damage to mobile home, and paid for portion of damages, the cause of which could not be determined with certainty.

Christopher Cofield's mobile home allegedly was damaged during a storm on April 27, 2011. At that time, Cofield's mobile home was covered by a Manufactured Home Policy of

Insurance issued by Allstate. Shortly after the storm, Cofield notified Allstate of the damage to his mobile home and Allstate began an investigation of his claim. After three adjusters and a

Licensed Professional Engineer inspected the mobile home and determined that much of the damage was unrelated to the storm and instead attributable to events not covered under the policy, Allstate issued a check to Cofield for the covered damage. Cofield disagreed with the determination that most of the damage was not related to the storm, returned the check, and filed suit in Alabama state court alleging (1) breach of contract, (2) fraud, (3) bad faith, and (4) negligence and wantonness in investigating his claim. Allstate removed to federal district court and then moved for partial summary judgment on all counts except the claim for breach of contract. The district court granted Allstate's motion.

Cofield alleged that Allstate acted in bad faith in refusing to provide him with benefits under the contract of insurance sufficient to repair all of the damage to his mobile home. He asserted that Allstate failed to determine whether there was a reasonably legitimate, arguable, or debatable reason to refuse to pay his claim, and that Allstate failed to investigate properly the damage to his mobile home.

The court, citing Alabama precedent, explained that to prevail on a bad faith claim for failure to properly investigate an insured's claim, the insured must show "(1) that the insurer failed to properly investigate the claim or to subject the results of the investigation to a cognitive evaluation and review, and (2) that the insurer breached the contract for insurance coverage with the insured when it refused to pay the insured's claim."

Here, Allstate undertook a thorough investigation of the claim by having three different adjusters and a Licensed Professional Engineer inspect and assess the damage to Cofield's mobile home before making a coverage decision on Cofield's claim. The Licensed Professional Engineer concluded that much of the damage was caused by racking and warping of the mobile home's frame and was not attributable to the storm. The Licensed Professional Engineer, however, was unable to determine with certainty whether the storm damaged the metallic skirt around the bottom of the mobile home, and therefore recommended that Allstate repair the skirt and level the mobile home. Allstate accepted this recommendation and issued a check for payment for damage to the metallic skirt and for the re-leveling of the mobile home.

The court explained that bad faith "is not simply bad judgment or negligence," but instead "imports a dishonest purpose and means a breach of known duty, i.e., good faith and fair dealing, through some motive of self-interest or ill will." The court noted that Cofield had failed to submit any evidence that Allstate intentionally or recklessly failed to subject his claim to a cognitive evaluation or review, and had not provided any evidence of a lack of a debatable reason for Allstate's decision. The court also noted that Allstate did not refuse to pay the claim; it simply tendered less than the amount Cofield believed was owed under the policy. The court therefore ruled that Cofield had failed to establish a bad faith claim and entered summary judgment for Allstate.

Eastern District of Pennsylvania: Insureds' Failure To Provide Certain Information Requested By Insurer Was Not So Clearly Prejudicial As To Allow Summary Judgment For Insurer

Page v. Infinity Indem. Ins. Co., No. CIV.A. 13-1118, 2014 WL 413914 (E.D. Pa. Jan. 31, 2014).

Infinity denied its insureds' claim after the insureds provided most, but not all, of the information Infinity sought in its investigation of possible fraud. The court found Infinity's investigation reasonable but denied its motion for summary judgment, concluding that Infinity failed to show that the insureds' non-cooperation was indisputably and substantially prejudicial.

Early on the morning of July 26, 2011, Stephen Page and Keisha Prewitt, a married couple, were informed that their SUV, a 2002 Mercury Mountaineer, was on fire. The vehicle had been parked on the street near their house.

Page and Prewitt had an automobile policy covering the Mountaineer with Infinity Indemnity Insurance Company ("Infinity"). They promptly informed Infinity of the incident and filed a claim. In the days following, Page and Prewitt provided

an Infinity investigator with requested documents and recorded statements.

This initial investigation uncovered several concerns that caused Infinity to suspect Page and Prewitt were attempting to commit insurance fraud. Among these: a third-party expert found that the fire had been caused by arson; Page and Prewitt had several unpaid loans that had been referred to collection agencies, but had missed no payments on either the Mountaineer or its policy; and Page and Prewitt's house had allegedly been burglarized three days before the fire, causing them to lose \$3,000 in cash and valuables. After Infinity referred the case to its special investigation unit, it also discovered that Page had been shopping for cars at various dealerships shortly before the fire. When questioned, Page was unable to identify the specific dealerships he visited.

In September 2011, Page and Prewitt informed Infinity that they had obtained counsel, Jay Solnick, and that further inquiries should be directed to Solnick. When Infinity's special investigator requested that Page and Prewitt provide Page's June and July 2011 bank statements, the car dealerships visited by Page, and a copy of the police report concerning the earlier robbery, Solnick questioned the need for these items and did not agree that his clients would provide them. Infinity then sent Solnick a letter advising him that Page and Prewitt's claim could be denied if they failed to cooperate with the investigation and that Infinity would deny the claim if it did not receive the requested items by late October. On November 2, Infinity closed its investigation and denied the claim in a letter to Solnick.

In January 2013, Page and Prewitt filed a complaint against Infinity in Pennsylvania state court, alleging bad faith and breach of contract. Infinity removed the action to U.S. District Court. During his deposition, Page provided the locations of

the car dealerships he had visited before the fire. With this information, Infinity reopened its investigation on September 6, 2013 and agreed to pay Page and Prewitt's original claim on September 30. The parties subsequently settled the breach of contract claim, and Infinity moved for summary judgment on the bad faith claim.

To prevail on a bad faith claim in Pennsylvania, a plaintiff must show, by clear and convincing evidence: (1) defendant had no reasonable basis for its investigative tactics concerning plaintiff's claim or its denial of the claim; and (2) defendant either knew or recklessly disregarded this lack of reasonable basis. In its motion, Infinity argued that it had a reasonable basis for both its investigation and denial of Page and Prewitt's claim as a matter of law.

The court agreed with Infinity that its investigation was reasonable. The likely arson, Page and Prewitt's outstanding debts, and Page's car shopping, among other items, were "red flags" that gave Infinity a reasonable basis to investigate Page and Prewitt's claim to determine whether they had committed fraud.

The court held, however, that Infinity had not shown that Page and Prewitt's non-cooperation was "indisputably substantial and prejudicial" to Infinity. The court found that whether Page and Prewitt's withholding of the bank statements or the police report prejudiced Infinity's investigation were disputed questions for the finder of fact. Further, it found that Page's failure to supply the names of the specific dealerships he visited did not constitute "substantial non-cooperation" as a matter of law. Therefore, because Infinity could not show that its denial of Page and Prewitt's claim was reasonable as a matter of law, the court denied Infinity's motion for summary judgment on the bad faith claim.

New Jersey Superior Court: Privilege Attaches in Communication between Law Firm and Independent Claims Adjuster in Action Against Defendant Insurer

Friedman Route 10, LLC v. Certain Underwriters At Lloyd's, London, A-0434-13T1, 2014 WL 340087 (N.J. Super. Ct. App. Div. Jan. 22, 2014) (per curiam) (not reported in A.3d).

Superior Court of New Jersey upholds attorney-client privilege for communications between defendant insurer's outside counsel and independent claims adjuster, where outside counsel was performing legal services for defendant insurer and claims adjuster "shared a common interest" with defendant insurer.

Friedman Route 10, LLC filed an insurance claim with Certain Underwriters at Lloyd's London (Lloyd's). Because Lloyd's could not conduct business in New Jersey (pursuant to state statute), Lloyd's retained Raphael & Associates ("Raphael"), an independent claims adjuster, to investigate and adjust plaintiff's claim. Lloyd's also retained the law firm of Powell & Roman, LLC ("Powell") to provide a coverage opinion and legal analysis of the claim. During this time, Raphael represented itself to Friedman Route 10 as acting on Lloyd's behalf (even though Lloyd's retained the ultimate decision as to denial or acceptance of coverage and payment of claims). Powell submitted legal bills to Raphael for review and approval, and all initial communications between Friedman Route 10 and Lloyd's were done through Raphael.

When the parties were unable to adjust the claim, Friedman Route 10 commenced an action against Lloyd's in the Law Division of the New Jersey Superior Court. Friedman Route 10 issued a subpoena to Raphael for its file on the matter. Powell produced all but sixteen documents from Raphael's file; the withheld documents were itemized in a privilege log pursuant to the argument that they constituted privileged attorney-client communications. Friedman Route 10 objected, arguing that Powell was retained by Lloyd's, and Raphael was a separate entity that was never Powell's client. Two judges in the Law Division held in succession that the documents should be produced, as there was "insufficient specificity on the papers" for the court to decide whether the items were privileged.

Lloyd's moved for reconsideration again on the basis that the documents were privileged and, for the first time, that they were protected under the attorney work product doctrine and the common interest doctrine; the motion was denied and the defendant was ordered to produce the documents. Lloyd's then appealed the interlocutory order to the Superior Court of New Jersey Appellate Division.

Applying the New Jersey Supreme Court's rationale in *Payton v. N. J. Tpk Auth.*, 148 N.J. 524 (1997), the Appellate Division noted that "privilege would not attach if Powell's role here was simply to render routine claims investigation services," but that in the instant case, "Powell was tasked with conducting legal research of the various issues surrounding plaintiff's claim, and to provide a legal opinion." (emphasis added). Therefore, attorney-client privilege should attach as to Powell.

The court also rejected Friedman Route 10, LLC's contention that Powell represented Lloyd's, not Raphael, when the communications were made and therefore Raphael could not claim the privilege because it was not outside counsel's client. Applying the "common interest doctrine," the court focused on "the nature and origin of the relationship" between Lloyd's and Raphael, and found that Raphael "clearly shared a common interest with Lloyd's in investigating and adjusting Friedman Route 10, LLC's claim." The court noted that Lloyd's could not conduct business in New Jersey and therefore had to use agents like Raphael out of necessity. Additionally, even before Raphael was added as a defendant,

an employee of Raphael was authorized to certify interrogatory answers from Lloyd's, and an attorney of Raphael attended mediation as a Lloyd's representative. Further, the court did note that the privilege might be waived if Lloyd's were to use "advice of counsel" as a defense to the claim; however, that

defense had not been affirmatively raised and so a finding of waiver would be premature. Therefore, after an individualized review of the documents in question, the court found that privilege attached to all but one of the withheld documents containing communications between Raphael and Powell.

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