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Insurance Practice

The Bad Faith Sentinel

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

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Case of First Impression: In Florida, The Law of The Place of Contracting Governs First-Party Bad Faith Claims

Higgins v. West Bend Mut. Ins. Co, No. 5D10-3747, 2012 WL 1057627 (Fla. App. 5 Dist. Mar. 30, 2012)

In a case of first impression, the Fifth District Court of Appeals of Florida applies the law of the place of contracting in deciding first-party bad faith claim.

In 1999, Ann Louise and Anthony Higgins were vacationing in Orlando, Florida when they were injured in an automobile accident caused by another driver. The Higginses were insured by West Bend Mutual Insurance Company ("West Bend"), a Wisconsin corporation, under an automobile insurance policy obtained in Minnesota. The policy provided underinsured motorist coverage up to $100,000 per person and $300,000 per accident.

The Higginses brought suit in Florida against the at-fault driver, whose policy limit was $100,000, and West Bend. The at-fault driver settled for $100,000, but West Bend disagreed with the value of the claim and refused to settle. A jury awarded the Higginses $260,000 and, after setoff of the driver's settlement, West Bend was ordered to pay the policy's underinsured motorist coverage limit of $100,000.

In 2007, the Higginses filed a bad faith action against West Bend pursuant to Florida law for failing to settle their claim. The policy did not contain a choice of law provision. West Bend argued that Florida law did not apply to the claim because the policy was issued in Minnesota, and therefore Minnesota law applied to the action. The trial court agreed with West Bend and, applying Minnesota law, which does not provide for first-party bad faith claims, granted summary judgment to West Bend. The Higginses appealed, arguing that the trial court erred and failed to apply the Florida conflict of law principles to apply the law of the place of performance.

Under Florida law, substantive questions bearing on the interpretation, validity and obligations of contracts are determined by the law of the place where the contract was executed. Questions regarding the manner or method of performance, however, are determined by the law of the place of performance. The Fifth

District Court of Appeal of Florida noted that determining which choice of law rule applies to first-party bad faith actions presented a question of first impression.

The Higginses argued that the actions or omissions by West Bend raised a performance question under the contract and the applicable law should be the place of performance – Florida. Conversely, West Bend contended that the question of whether it acted in bad faith was substantive, and should be determined by the place of contracting – Minnesota.

The Fifth District Court noted that where third-party claims are brought, it is the insurer's conduct or performance that leaves the insured exposed to excess liability. However, first-party claims are brought by injured insureds to obtain the benefits due to them under their policies. Accordingly, the question was whether West Bend operated under the terms of its contract in handling the Higginses' claim. Because West Bend's refusal to tender the limits presented a substantive question, the Fifth District Court held that Minnesota law applied to the action.

Moreover, the Fifth District Court held that Minnesota law would still apply even if the law of the place of performance would be the appropriate choice of law. The conduct that gave rise to the bad faith claim was West Bend's failure to pay benefits to the Higginses. The Higginses were Minnesota residents, and thus, the benefits were due to the them in Minnesota – not Florida. Consequently, Minnesota was the place of performance. In determining applicable law, the court also took into consideration which state's interest was most significant. The court held that Florida had no interest in bad faith actions between a foreign driver and a foreign corporation. Based on its analyses, the Fifth District Court affirmed the trial court's decision to grant West Bend summary judgment.

Pennsylvania Superior Court Reaffirms Holding that Violations of Statutes Related to Insurance Practices May Be Evidence of Bad Faith

Berg v. Nationwide Mut. Ins. Co., Inc., No. 12 MDA 2008, 2012 WL 1313055 (Pa. Super. Ct. Apr. 17, 2012)

Pennsylvania Superior Court vacates a trial court's directed verdict for an insurer based on multiple errors, including failure to apply prior precedent.

On September 4, 1996, Daniel and Sheryl Berg's Jeep Grand Cherokee sustained extensive damage in an accident. The Bergs were insured by an automobile policy issued by Nationwide Mutual Insurance Company ("Nationwide").

The Bergs chose to have the Jeep repaired at Lindgren Chrysler-Plymouth, Inc. ("Lindgren"), a facility participating in Nationwide's direct repair program, "Blue Ribbon Repair Service Program" ("BRRP"). The repairs took approximately four months and the Jeep was returned to the Bergs on or about December 30, 1996.

In October 1997, a former employee of Lindgren called the Bergs and informed them of possible structural repair failures to their Jeep. As a result, the Bergs filed suit against Lindgren and Nationwide. The trial court bifurcated the claims at trial. In the first phase of trial, the jury first found that Nationwide and Lindgren violated the catchall provision of the Pennsylvania Uniform Trade Practices and Consumer Protection Law, 73 P.S. § 201-2(4)(xxi) ("UTPCPL"), but found in favor of Lindgren and Nationwide on the common law fraud and conspiracy claims.

The next phase of the trial was on issues of treble damages under the UTPCPL and claims pursuant to the Pennsylvania bad faith insurance statute, 42 Pa. C.S.A. § 8371. After oral argument, the trial court granted Nationwide's motion for directed verdict on the Bergs' bad faith claims. The trial court

entered the directed verdict because (1) Pennsylvania's bad faith insurance statute did not apply because the BRRP was not part of Nationwide's insurance policy, and (2) a jury's verdict against Nationwide for violating the catchall provision of the UTPCPL did not require a finding of bad faith against Nationwide. The Bergs appealed the trial court's ruling.

The Superior Court of Pennsylvania found that the trial court erred in dismissing the Bergs' bad faith claims. The trial court found that the Bergs' claim for bad faith damages was premised upon Nationwide's failure to guarantee the repairs made to their Jeep under the BRRP, and that the Bergs alleged the BRRP was part of their insurance policy. The Superior Court, however, found that the Bergs' claim for bad faith did not mention the BRRP. Instead, the Bergs had alleged that Nationwide acted in bad faith in not effectuating "the prompt, fair and equitable settlement of [the Bergs'] claim." Consequently, the Superior Court found the Bergs' claims did "arise under an insurance policy" as required by the statute and the trial court erred in holding otherwise.

The trial court also erred in by misapplying *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228 (Pa. Super. Ct. 1994). *Romano* held that bad faith conduct under Section 8371 may be defined by reference to violations of statutes related to insurance practices. The Bergs had argued that under *Romano*, the jury's finding that Nationwide violated the UTPCPL constituted some evidence of bad faith conduct by Nationwide. The Bergs' argument did not rely solely on *Romano*, but instead offered evidence of multiple instances of bad faith conduct by Nationwide sufficient to satisfy the definition of bad faith under *Toy v. Metropolitan Life Ins. Co.*, 593 Pa. 20 (Pa. 2007). In *Toy*, the Pennsylvania Supreme Court reaffirmed that the term "bad faith" under section 8371 concerned "the duty of good faith and fair dealing in the parties' contract and the manner in which an insurer discharged … its obligation to pay for a loss in the first party claim context."

The trial court also erred in its refusal to admit evidence of Nationwide's nearly $1 million defense costs. The Bergs claimed that the defense costs were pursuant to a documented litigation strategy designed to deter the filing of small value claims. In addressing the trial court's error, the Superior Court pointed to its decision in *Bonenberger v. Nationwide Mut. Ins. Co.*, 791 A.2d 378 (Pa. Super. Ct. 2002), in which the Court held that Nationwide's use of an internal practice manual detailing aggressive litigation tactics was relevant evidence to support the ultimate finding of bad faith.

Finally, the trial court erred in its refusal to conduct an *in camera* review of redactions to Nationwide's claim log related to the repairs to the Bergs' Jeep. The Superior Court noted that in bad faith insurance litigation, the fact finder must consider all of the evidence available. Accordingly, the Superior Court held that the trial court should conduct an *in camera* review of the documents prior to retrial of the Bergs' bad faith claims. The Superior Court vacated the trial court's judgment and remanded the case for a new trial on their bad faith claims.

Insurer That Did Not Issue Policy or Collect Premiums, But Oversaw Defense of Lawsuit, Was Not Liable Under Bad Faith Statute

***McLaren, CNM v. AIG Domestic Claims, Inc.*, No. 10-cv-04224, 2012 WL 1071217 (E.D. Pa. Mar. 30, 2012).**

In Pennsylvania, a claimant must allege that a party issued a policy, collected premiums and assumed certain risks in order to state a claim for bad faith.

In April 2004, Andrea McLaren, a certified nurse midwife ("CNM"), applied for professional liability insurance coverage on a pre-printed form she obtained from the American College of Nurse Midwifes ("ACNM"). The name "National Union Fire Insurance Company of Pittsburgh, PA" appeared at the top of the application form. After submitting the application, McLaren received a "Certificate of Liability Insurance" from Contemporary Insurance Services ("Contemporary"), an

ACNM-sponsored insurance broker. The insurance policy issued pursuant to McLaren's application was written by National Union. National Union provided coverage to McLaren in exchange for her premium payments for the 2004-2005 and 2005-2006 policy years.

On February 27, 2006, Tracy and Daryle Miller filed a civil action against McLaren and St. Luke's Hospital of Bethlehem alleging negligence and seeking damages for the death of their son, who died in August 2004. Upon receipt of the lawsuit, McLaren notified Contemporary, which in turn forwarded the lawsuit to AIG, a wholly-owned subsidiary of National Union. AIG notified McLaren that the claims asserted by the Millers fell within the coverage parameters of the policy and that defense counsel would be appointed.

Throughout the Miller litigation, McLaren was committed to fully defending herself against the claims and insisted that the claim not be settled. The trial lasted four weeks, ultimately resulting in a mistrial because of the jury's inability to reach a verdict on the issue of liability. During the second week of the trial, McLaren signed a "consent to settle" form granting AIG authority to settle the claim for the limits of her policy. AIG, MCARE and St. Luke's Hospital commenced settlement negotiations with the Millers that continued through the remainder of the trial. The parties were unable to reach a settlement before the mistrial was declared.

After the mistrial, McLaren contacted her AIG-appointed attorney and expressed concern over having been pressured to sign the "consent to settle" form. She further informed counsel that she was no longer willing to consent to settlement because the jury's deadlock on the issue of liability reaffirmed her belief that she had not acted negligently. Nevertheless, at a post-trial settlement conference, AIG, MCARE and St. Luke's made a global settlement offer that included the $500,000 policy limits of McLaren's policy. McLaren's personal attorney, on the day before the settlement offer was to expire, formally notified AIG and McLaren's trial counsel that McLaren revoked any consent to settle the claims. AIG subsequently refused to tender the $500,000 limit of McLaren's policy to the MCARE Fund, thereby preventing consummation of the global settlement. The Millers petitioned the trial court to enforce the settlement, a petition that the trial court granted. On June 5, 2009, the settlement in the Miller litigation was posted on the National Practitioner Data Bank.

McLaren subsequently sued AIG for breach of contract and bad faith. McLaren alleged that AIG was not authorized to settle any claims on her behalf without her express consent and that her initial consent was obtained under duress. McLaren further contended that AIG had no reasonable basis to insist on her consent to settle the claims because AIG faced no exposure beyond the $500,000 policy limits whether the litigation settled or went to verdict. McLaren attached her insurance contract with National Union to her complaint and did not allege the existence of a separate contract between herself and AIG.

In the complaint, McLaren argued that AIG is the alter ego of National United and was therefore liable under the insurance contract between McLaren and National United. In support of her alter ego contentions, McLaren argued that (1) she had no direct communications with either National Union or AIG until the commencement of the underlying Miller litigation; (2) upon receipt of the lawsuit, McLaren notified her insurance broker, who forwarded the lawsuit to AIG; and (3) AIG contacted McLaren to acknowledge receipt of the lawsuit and inform her that the suit fell within her insurance policy's coverage parameters. Moreover, McLaren argued, AIG engaged in a course of conduct in which it operated as McLaren's insurer, including acknowledging receipt of the lawsuit, appointing defense counsel, directing defense counsel's activities and directly communicating with McLaren regarding trial.

The District Court for the Eastern District of Pennsylvania, in ruling on AIG's motion to dismiss, held that, based on the allegations of the complaint, AIG could not be considered an alter ego of National Union. The court explained that McLaren's allegations related almost entirely to AIG's actions regarding McLaren's defense and not to the factors a court must consider when determining whether AIG is the alter ego of National Union (e.g. failure to observe corporate formalities, commingling of funds, etc.).

The court, turning to McLaren's bad faith claim, rejected McLaren's argument that AIG was her "de facto insurer." AIG argued that McLaren was not an "insured" within the meaning of the Pennsylvania bad faith statute so that the claim should be dismissed. McLaren countered that although National Union's name appeared on her policy, AIG acted as her insurer, thereby rendering AIG liable for bad faith. AIG contended that it did not act as an insurer with respect to McLaren because it did not (1) issue the policy, (2) collect premiums, or

(3) assume certain risks and contractual obligations with McLaren in return for the premiums. The court ruled that because McLaren's contention that AIG acted as her insurer was grounded in averments regarding AIG's role in the underlying litigation, rather than the issue of the policy, collection of premiums, or bearing of risk by AIG, the complaint did not aver sufficient facts to support a finding that AIG was McLaren's insurer within the meaning of the bad faith statute.

In The Ninth Circuit, A Failure to Produce Support for Damages Claim Did Not Justify Dismissal Sanctions

***R & R Sails, Inc. v. Insurance Co. of the State of Pennsylvania*, Nos. 10-55155, 10-55888, 2012 WL 933830 (9th Cir. Mar. 21, 2012).**

The Court of Appeals for the Ninth Circuit held that an insured's failure to produce proof of damages in connection with its bad faith claim did not necessitate a Rule 37(c) sanction of dismissal

R & R Sails, Inc. ("R & R"), the owner of Hobie Cat Australasia Pty. Ltd. ("Hobie Cat"), an Australian corporation in the watercraft manufacturing and distribution business, submitted a claim to its insurer, American International Group, Inc. ("AIG"), after a December 2011 wildfire damaged Hobie Cat's manufacturing and sales facility in Woolamia, Australia. AIG paid portions of the claim, but declined to pay others. R & R sued AIG for breach of contract, unfair competition and tortious bad faith. On its bad faith claim, R & R sought punitive damages, attorney's fees, and costs incurred to obtain its policy benefits, pursuant to *Brandt v. Superior Court*, 693 P.2d 796 (Cal. 1985) ("*Brandt* fees").

In its initial Rule 26 disclosures, R & R disclosed that it sought $350,000 in *Brandt* fees and stated that the amount was an estimate that would be amended at the time of trial. R & R did not specifically state in the disclosures that it planned to use invoices to support its claim for *Brandt* fees, nor did it produce any invoices to AIG. AIG did not ask R & R to produce documents supporting the *Brandt* fees claim until three months after the close of fact discovery. Specifically, AIG served a notice of deposition on R & R's damages expert in which it requested production of all documents relating to R & R's damage claims. Neither R & R nor the expert produced the invoices at that time.

Nearly a year after the damages expert's deposition, the District Court for the Southern District of California issued a final pretrial schedule that instructed the parties to make pretrial disclosures of documents that may be presented at trial. R & R, in its pretrial memorandum, stated that it would support its request for *Brandt* fees with an exhibit comprised of invoices reflecting attorneys fees and costs incurred by Hobie Cat. R & R also revised its estimate of the *Brandt* fees to reflect a sum of more than $450,000. AIG's memorandum, filed on the same day, noted "R & R Sails has not provided any evidence in discovery or under Rule 26 in support of the claims for attorney's fees." Soon after the exchange of memoranda, AIG's counsel began requesting the invoices, to no avail. While R & R delivered copies of many of its exhibits to AIG, it failed to produce the invoices. The parties proceeded to file objections to each other's pretrial disclosures. R & R also sought clarification of whether the request for fees would be made to the court or the jury, at what stage the request would be made, and whether redacted copies of the billings and costs would be sufficient. AIG objected to the invoices exhibit on the ground that it was never produced. R & R continued to delay production of the invoices.

Just over a week before the final pretrial conference, AIG paid R & R $1,127,246 in full satisfaction of R & R's outstanding

claims for benefits, plus interest. With the payment, R & R's breach of contract claim was resolved and because the court had previously granted summary judgment on R & R's unfair competition claim, only R & R's bad faith tort claim, and its accompanying request for Brandt fees and punitive damages, remained in dispute.

Before trial, AIG filed a motion in limine seeking to preclude R & R from introducing any evidence in support of its *Brandt* fees claim at trial, noting that R &R failed to comply with Rule 26 and the Judge's pretrial order. In its opposition, R & R argued that AIG never requested the documents and that it had complied with the "spirit and purpose" of Rule 26. The district court granted the motion in limine, ruling that R & R had violated Rules 26(a) and 26(e) and that the violation was not harmless. The court excluded R & R's *Brandt* fees evidence as a sanction pursuant to Federal Rule of Civil Procedure 37(c)(1).

R & R moved for reconsideration of the court's ruling, acknowledging that AIG had requested the invoices, but stating that AIG had insisted the invoices had to be completely redacted before production and that R & R expected the court to resolve the redaction dispute at the final pretrial conference. R & R then provided AIG with copies of the invoices in unredacted form. The court denied the motion for reconsideration.

The district court then granted AIG's subsequent motion for judgment as a matter of law on R & R's bad faith claim. The court first determined that, with the *Brandt* fees evidence, R & R could present no evidence of compensatory damages. The court then concluded that R & R's punitive damages claim failed because it could not present evidence of compensatory damages as required by California statute.

R & R timely appealed the grant of judgment as a matter of law on its bad faith claim. The Court of Appeals for the Ninth Circuit determined the district court did not abuse its discretion in finding that R & R failed to meet its obligations under Rule 26. The Court of Appeals did not agree, however, that the trial court made findings sufficient to support its preclusion of the invoices. Noting that the sanction was particularly harsh "because it dealt a fatal blow not only to R & R's entire *Brandt* fees claim, but also its request for punitive damages." The court concluded the sanction amounted to dismissal of a claim. In accordance with that determination, the Court of Appeals remanded the case for an inquiry into whether the claimed non-compliance involved willfulness, fault or bad faith.

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