

Insurance Coverage Update Pennsylvania

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INSURANCE COVERAGE

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PSMN Secures Another TCPA Coverage Win

PSMN recently secured another favorable decision that commercial general liability policies do not afford coverage for claims that the policyholder sent blast faxes in violation of the Telephone Consumer Protection Act (“TCPA”), 47 U.S.C. § 227. In Advent Home Mortgage Corporation v. Hartford Cas. Ins. Co., No. 06-1582 (E.D. Pa. August 14, 2006), Magistrate Judge Hart issued a Memorandum and Order finding that TCPA claims would not fall within either the property damage or advertising injury coverages of Hartford’s policy, which used the ISO form. Since the parties agreed to refer the matter to the Magistrate for final disposition, and no appeal was taken to the Third Circuit, the decision is final.

Bell, doing business as Allegiance Mortgage Services, filed a class action complaint against Advent in Pennsylvania state court alleging that Advent had violated the TCPA by sending unsolicited faxes regarding mortgage products to Bell and others. Advent sought coverage for the suit from Hartford, which had issued a policy containing a Business Liability Coverage Form. The Coverage Form included coverage for “property damage” caused by an “occurrence.” “Property damage” was defined to include both “physical injury to tangible property,” including loss of use thereof, and “loss of use of tangible property.” The Coverage Form also included coverage for “personal and advertising injury” caused by “an offense arising out of your business.” One of the enumerated offenses was “oral, written or electronic publication of material that violates a person’s right of privacy.”

After Hartford declined coverage, Advent filed suit in the Court of Common Pleas of Chester County, which was removed to federal court. Since copies of the underlying Bell complaint and the relevant portions of Hartford’s policy were attached to the pleadings, Hartford moved for judgment on the pleadings. Advent then cross-moved.

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Pennsylvania Supreme Court Holds Faulty Workmanship Is Not An Occurrence

In a case seeking insurance coverage for claims of breach of contract and breach of warranty, the Pennsylvania Supreme Court unanimously held (with two justices not participating) “that the definition of ‘accident’ required to establish an ‘occurrence’ under the policies cannot be satisfied by claims based upon faulty workmanship.” Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co., et al., 2006 Pa. LEXIS 2064 at *27 (Pa. October, 2006). The underlying complaint alleged that Kvaerner had contracted to design and build a coke oven battery and that the battery failed to meet specifications. The underlying plaintiff alleged breaches of the contract and resulting damages and attached to and incorporated into its complaint the “nonperformance list” previously sent to Kvaerner. The damages sought were the amount to replace the defective battery or the cost difference between the defective battery and one as warranted.

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The Court first addressed Advent's contention that the underlying complaint alleged "property damage ... caused by an occurrence." Unlike many TCPA complaints, the underlying complaint did not allege that the facsimiles sent by Advent used fax paper, toner or tied up any fax machines, allegations which other courts have found to allege "loss of use" and thus "property damage." Hartford therefore first argued that the Bell Complaint did not allege property damage. The Court rejected that argument for the same reason that courts have found the absence of an "accident," i.e., that anyone familiar with a fax machine understands that receipt of a fax necessarily involves the use of the recipient's supplies. Thus, the Court found that "property damage" had been alleged by the mere allegation that the underlying plaintiff "received on her facsimile machine an unsolicited advertisement." Interestingly, many modern office environments now direct faxes through computer systems that do not necessarily result in the use of a traditional fax machine. However, since the duty to defend is based solely upon the four corners of the complaint when compared to the provisions of the policy, any examination of the underlying facts would not have allowed Hartford to seek an early decision.

For the same reason the court found "property damage" to have been alleged, the Court then concluded that the underlying complaint did not allege an "accident," following a line of decisions such as Resource Bankshares Corp. v. St. Paul Fire & Marine Ins. Co., 407 F.3d 631 (4th Cir. 2005) and Melrose Hotel Co. v. St. Paul Fire & Marine Ins. Co., 432 F. Supp.2d 488 (E.D. Pa. 2006). Advent argued that its intentional act of sending faxes was not intended to cause property damage to the recipients because as a mortgage lender, it was not unreasonable for it to believe it had the consent of the mortgage brokers to whom it sent faxes due to the symbiotic relationship that exists between mortgage lenders and mortgage brokers. The Court rejected this "accidental fax" argument following Resource Bankshares and Melrose Hotel, and noting that Advent's beliefs based upon its relationship with mortgage brokers, which might suggest implied permission, was unavailing since the TCPA prohibits fax advertisements without "express invitation or permission."

The Court then agreed with Hartford that the Bell complaint did not allege "a publication of material that violates a person's right of privacy." Hartford argued that the plain meaning of the provision is that the

material's content must violate the person's right of privacy. Advent countered that the word "privacy" was ambiguous because it wasn't defined in the policy and had to be construed against the insurer. The court disagreed, citing the Third Circuit's earlier pronouncement in County of Erie v. Guaranty Nat. Ins. Co., 109 F.3d 156 (3d Cir. 1997), that "where a term is not defined in an insurance policy but possesses a clear legal or common meaning that may be supplied by a court, the contract is not ambiguous." The Court noted that "[w]e believe most people would agree that insurance policies are long enough, as it is. We see no need to torture the public further by requiring that terms with common meanings or whose meaning can be discovered in the context of the policy be defined in the policy."

The Court then reviewed the various decisions around the country on the issue. The Court noted that in Melrose Hotel, the only decision applying Pennsylvania law, Judge Schiller of the same court had rejected the reasoning of those courts, such as Park Univ. Enterprises, Inc. v. American Cas. Co. of Reading, Pa., 442 F.3d 1239 (10th Cir. 2006), which had focused on the word "privacy" to find that the same provision in the Hartford policy was intended to protect privacy rights of any kind. After quoting from Melrose Hotel that the question was not what Congress intended in enacting the TCPA, but what the word meant in the policy, the Court agreed with Hartford that "the clear and unambiguous meaning of the clause at issue is the right to secrecy, not seclusion." The clause itself dealt with a publication, and when read in the context of the "personal and advertising injury" coverage in the policy, the offenses related to the content of the material, not the method of publication. "Thus, it is clear that it is the secrecy aspect rather than seclusion aspect of privacy that is covered by the clause."

Note that Hartford's policy contained an exclusion for personal and advertising injury "arising out of a violation of a person's right of privacy created by any state or federal act." Since the Court held that there was no coverage, it never reached this exclusion. ♦

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National Union denied coverage for various reasons, including lack of an occurrence and applicability of business risk exclusions. Kvaerner countered that the battery was damaged by an accident because it had grouted the bricks to the battery roof too early, which

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in combination with monsoon-type rains, resulted in movement of the roof and subsequent damage to the battery, all of which were unexpected. Kvaerner further argued that the policy provided completed operations coverage and the damage occurred after the battery was completed. The trial court granted National Union's motion for summary judgment, but the Superior Court reversed, looking beyond the allegations in the underlying complaint to the expert report detailing the roof movement theory of damage to the battery. National Union appealed.

The Pennsylvania Supreme Court first held that the Superior Court erred in looking beyond the allegations of the underlying complaint.

In doing so, it departed from the well-established precedent of this Court requiring that an insurer's duty to defend and indemnify be determined solely from the language of the complaint against the insured. Haver, 725 A.2d at 745, Allen, 692 A.2d at 1095, Wilson, 105 A.2d at 307. We find no reason to expand upon the well-reasoned and long-standing rule that an insurer's duty to defend is triggered, if at all, by the factual averments contained in the complaint itself.

The Court then reiterated that the duty to defend is determined by comparing the policy to the allegations in the underlying complaint. If the language of the policy is clear and unambiguous, the court must give effect to that language.

The Court noted that the policy, in pertinent part, required National Union to defend a suit seeking damages for property damage which is the result of an occurrence, where occurrence is defined as an accident. The Court noted that the key portion of the ordinary definition of the word accident is "unexpected" and "[t]his implies a degree of fortuity that is not present in a claim for faulty workmanship." The Court favorably cited opinions from other jurisdictions and the Pennsylvania Superior Court's opinion in Snyder Heating v. Pennsylvania Mfr's Assoc. Ins. Co., 715 A.2d 483 (Pa. Super. 1998), which held that the insurer did not owe a defense or indemnification to the insured for a suit against it alleging breach of contract and damage to a school's boilers due to the insured's failure to properly maintain the boilers.

Finally, the Court noted that the underlying complaint only alleged damage to work product and incorporated the nonperformance list detailing the deficiencies. Thus, because faulty workmanship is not an accident, National Union owed no duty to defend or indemnify. Since the Court held no occurrence was alleged, it did not address the business risk exclusions. ♦

Pennsylvania Supreme Court Skirts Deciding Bad Faith Issue

When the Pennsylvania Supreme Court accepted review of the Superior Court's disturbing decision in Hollock v. Erie Ins. Exchange, 842 A.2d 409 (Pa. Super. 2004), Pennsylvania lawyers expected a decision from the Court on whether the lower court incorrectly extended Pennsylvania's Bad Faith Statute into the arena of the litigation of the coverage and bad faith action itself. Although the case was fully briefed and argued, the Court surprisingly issued an order two years after the appeal was filed dismissing the appeal as improvidently granted. That decision drew a sharp, written rebuke from Chief Justice Cappy, joined by Justice Castille, who chided the Court for refusing to decide the case. In the process, the Chief Justice made his view on the substance of the appeal known in a lengthy analysis (Pa. 2006); he would have reversed.

The Supreme Court has used "improvidently granted" orders, known as "IGs," to avoid deciding hard cases in the past. One Supreme Court Justice told a gathering of a County Bar Association's Civil Litigation section that when the Court is unable to reach a decision on a case after many drafts and more than 18 months, the Court may simply punt by issuing an IG. Justice Cappy obviously disapproved of that tool in this case.

A review of the lower courts' decisions provides necessary background. The case arose out of a claim for underinsured motorist coverage after the insured was rear-ended. The trial court found that Erie intentionally misled the insured's attorney about the limits and waited two years to request an independent medical examination and statement from the insured. Perhaps most importantly, although Erie did not challenge causation between the insured's injuries and the accident when it paid first party benefits for the same accident, it subsequently challenged causation when asked to pay underinsured motorists coverage. At arbitration, the insured was awarded \$500,000, which Erie paid. The insured then sued for bad faith. The trial judge on the bad faith claim found that Erie's conduct during the bad faith litigation itself was in bad faith. He determined that Erie's witnesses lied at trial,

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amounting to “an intentional attempt to conceal, hide or otherwise cover up the conduct of Erie employees.” The \$2.8 million punitive damages award was based in part on Erie’s conduct in the defense of the bad faith case.

On appeal, Erie argued that the trial court incorrectly extended the reach of Pennsylvania’s Bad Faith Statute to conduct during the defense of the bad faith case itself. In a 7-2 ruling of an *en banc* panel, the Superior Court disagreed, holding that a trial court’s finding of bad faith could rest on conduct during the trial itself. It was this decision that troubled many lawyers. Would the manner in which interrogatories were answered on behalf of the defendant insurer be evidence of bad faith? If an insurer interposed an objection to producing certain documents and was compelled after a motion to produce those documents, could that be bad faith? The reach of the Superior Court’s ruling was not only of great concern, it also appeared to allow a legislatively created statutory remedy to impinge upon the Supreme Court’s exclusive province to control and sanction, where appropriate, the conduct of litigants and lawyers through well-entrenched existing remedies such as the Rules of Civil Procedure and 42 Pa. C.S. § 2503.

Justice Cappy recognized not only the need for insurers and the bar to have guidance, but also saw the Superior Court’s interpretation of 42 Pa. C.S. § 8371 as an unjustified extension of the statutory cause of action.

First, Chief Justice Cappy criticized the Court for issuing an IG because the case clearly satisfied the well-recognized criteria for review by the Court: “The current case presents an excellent vehicle to consider all aspects of these issues.” The Chief Justice also saw that the Court’s refusal to address the substantive issues, no matter how difficult that task, merely delayed the day when the issue would be confronted.

As to the merits, Chief Justice Cappy embarked upon a thorough review of the history of the Bad Faith Statute and interpretive case law, and concluded that the statute simply did not support the interpretation that an insurer could be subject to punitive damages in a bad faith action due to the manner in which it defended itself during the course of that litigation. “It is only the conduct of the insurer in the processing of the insurance claim that is relevant to the resolution of the bad faith action. Should the insurer act inappropriately during the litigation process, that conduct can be

addressed through other available means. Reading the bad faith statute as extending the duty of the insure[r] beyond the life of the insurance policy is, in my opinion, incorrect.” *Id.* at 1188-89.

As a result of the Supreme Court’s decision to dodge the issues, insurers and their lawyers remain at risk of having their conduct during the litigation become fodder for use as evidence of bad faith. Among the many troubling ramifications is the plain fact that the Superior Court’s decision unfairly tips the scales in favor of the plaintiffs in bad faith cases whose conduct in litigation cannot be used against them. There is simply no support in the laws governing trials to effect this change. This consequence of the Superior Court’s ill-advised ruling, presumably unintended, is only one of the many traps now facing insurers in bad faith litigation. Only a new case raising the issue squarely, perhaps one where a trial judge allows a plaintiff to use a decision on a motion to compel answers to interrogatories as evidence of bad faith, may provide a vehicle for review of *Hollock*. ♦

One Month Extension of Policy Merely Extends Policy Period, It Does Not Provide Another Annual Limit of Coverage For That One Month

The Pennsylvania Superior Court affirmed summary judgment in favor of INA on an issue of first impression in the Pennsylvania appellate courts—the effect of a 30-day extension on policy limits. In *General Refractories Co. v. Ins. Co. of N. Am.*, 906 A.2d 610 (Pa. Super. 2006), the insured had a three-year excess blanket catastrophe liability policy with INA that it extended for 30 days to obtain new coverage. The policy limits were \$5 million per occurrence and \$5 million aggregate per policy year. The policy’s limits provision provided:

If the policy is issued for a period of three years, the limits of INA’s liability shall apply separately to each consecutive policy year thereof.

Years later the insured sought coverage under the policy due to multiple asbestos claims made against the insured. After INA paid \$15 million in claims, the insured sought an additional \$5 million and reimbursement for defense costs for claims falling within the 30-day extension period, contending the 30-day extension started a new policy year. The trial court rejected the insured’s claim and the insured appealed.

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One Month Extension of Policy Does Not Provide Another Annual Limit – Continued from Page 4

On appeal, the Superior Court held that the policy's unambiguous terms must be construed according to their ordinary meaning. The extension endorsement provided: "In consideration of an additional premium to be determined at audit, it is hereby agreed that the policy period is extended to 11/25/74." The Court considered the meaning of this provision in conjunction with the policy's limits provision and held:

The extension meant only that the policy year, and with it the original monetary limit, was protracted to encompass liability engendered during that period, not to increase the amount available to recompense such liability. Thus had Appellant been found liable only to the extent of the \$5 million attributable to the 13 month policy year, the problem would not have arisen. The point is that Appellant was not without coverage during the extension to thirteen months, but only that its coverage of \$5 million for that period remained constant over a variant time frame.

The Superior Court focused on the word "extended" and considered the "policy year" to have been extended. Courts from other jurisdictions have focused more on the meaning of "annual" (where the policy referred to "annual policy period") and the amount of premium charged for the extension and found ambiguity in the policy as to what limits were to apply. Those courts have ruled that another, equal limit applies to an extended period of coverage. See, e.g., U.S. Mineral Products Co. v. American Ins. Co., 792 A.2d 500 (N.J. Super. 2002) (holding that an extension of coverage for a shortened period gave rise to an additional set of aggregate policy limits in the same amount); Stonewall Ins. Co. v. Asbestos Claims Mgmt., 73 F.3d 1178 (2d Cir. 1995) (holding that a separate limit applied to a four-month extension). ♦

Insurance Broker Does Not Owe Duty To Inspect Property And Recommend Flood Coverage

On remand from the Pennsylvania Supreme Court, the Superior Court held that an insurance broker had no duty to inspect commercial property and recommend that its client obtain flood insurance. Wisniski v. Brown & Brown Ins. Co. of PA, 906 A.2d 571 (Pa. Super. 2006). The plaintiff contended that it used the

Brown agency to obtain insurance and that the agency recommended commercial liability and property insurance, but did not inspect the property which contained a stream and did not recommend flood insurance. The property later flooded and when the plaintiff notified the agency of the damage was told the policy did not cover flood damage. The plaintiff sued for negligence, alleging a breach of the duty to exercise the requisite skill in the insurance community.

Pursuant to the Supreme Court's mandate, the Superior Court assessed whether the Brown agency owed a duty to the plaintiff by applying the five-part test stated in Althaus v. Cohen, 756 A.2d 1166 (Pa. 2000):

The determination of whether a duty exists in a particular case involves the weighing of several discrete factors which include: (1) the relationship between the parties; (2) the social utility of the actor's conduct; (3) the nature of the risk imposed and foreseeability of the harm incurred; (4) the consequences of imposing a duty upon the actor; and (5) the overall public interest in the proposed solution.

With respect to the first prong, the Court held that the Brown agency acted as an insurance broker and the decision with which insurance company to contract always remained with the client, therefore no principal/agent relationship existed. The Court further held that "for ordinary negligence purposes, the relationship between an insurance broker and client is an arm's-length business relationship." But with respect to the social utility of the conduct, the Court found competing interests—i.e., the broker may have superior knowledge with respect to coverage available that an inspection may assist with in making recommendations but brokers may not have expertise in property inspection while the insured is also capable of inspecting its own property and making reasonable conclusions about its insurance needs.

"Regarding the third factor, a duty arises only when one engages in conduct which foreseeably creates an unreasonable risk of harm to others." The Court stated that the risk at issue is that an event causing damage would occur that is not covered by insurance because the broker did not inspect the property and recommend the requisite coverage, but it is difficult to determine the foreseeability of that risk and thus the risk-utility analysis did not favor either party.

With respect to the fourth prong, the Court held that imposing a duty to inspect on an insurance broker

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Insurance Broker Does Not Owe Duty To Inspect Property – Continued from Page 5

would be onerous. The Court then listed several concerns with imposing such a duty, including cost versus benefit, ability of the insured to provide relevant information without the need of an inspection, brokers may not have the expertise in their role as intermediary and may rely on loss control experts of insurance companies, it is difficult to say where the duty to inspect would end once imposed and imposing such a duty would reduce the insured's responsibility to seek appropriate coverage. The Court was also persuaded by a Missouri court's reasoning:

[B]y creating such a duty insureds would have the opportunity to seek coverage for a loss after it occurred merely by asserting that they would have bought additional coverage if it had been offered. This turns the entire theory of insurance on its ear as individuals, in theory, take an 'intellectual gamble' when purchasing insurance as they weigh the expense of insurance versus the amount of coverage that they purchase. Allowing insureds to seek coverage, post-occurrence, allows them to completely circumvent this risk.

(quoting Farmers Ins. Co., 871 S.W.2d 82, 86 (Mo. App. 1994)). The Court further stated that the problem with where to end the duty weighed heavily against recognizing such a duty.

As to the final factor, the Court held that there is no public policy in favor of imposing such a duty, particularly where the heavily-regulated insurance industry is generally exempt from negligence liability.

Thus, the Court held that the Althaus factors did not weigh in favor of a duty of insurance brokers to inspect property. Therefore, no duty was owed as a matter of law. ♦

For any questions on the topics addressed in this newsletter, please call Alan S. Miller at 412-288-4004 or Bridget M. Gillespie at 412-288-4017. ♦



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