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Third Circuit Upholds District Court’s Findings That Attorneys Fees are Costs, Prior Consent Is Required for Independent Counsel and Three-Month Notice is Reasonable

In *Scottsdale Ins. Co. v. The City of Hazleton*, 2010 U.S. App. LEXIS 23187 (3d Cir. Nov. 5, 2010), the Third Circuit upheld the granting of summary judgment in favor of Scottsdale Insurance Company on three insurance coverage issues arising out of an underlying case in which the insured city was enjoined from enforcing two ordinances involving regulation of illegal aliens. The Third Circuit recognized that the policy exclusion for “fees, costs or expenses which the insured may become obligated to pay as a result of any adverse judgment for declaratory relief or injunctive relief” included any attorney fees incident to the judgment in the underlying action. The Third Circuit also found that attorneys’ fees were in fact “costs” under the policy and not a form of “monetary damages.” Thus, the company was not required to indemnify the city for the attorney fees awarded in the underlying action. As to the second issue on appeal, the Court upheld the District Court’s decision that Scottsdale did not have any obligation to pay for an independent attorney’s services as Hazleton failed to obtain Scottsdale’s consent prior to retaining such counsel and no evidence showed a conflict of interest between the insured and the counsel appointed by Scottsdale. The final issue on appeal related to a bad faith claim against Scottsdale for its alleged failure to provide timely notice to Hazleton of the potential lack of coverage. The Third Circuit determined that the three-month delay in sending Hazleton a reservation of rights letter was not unreasonable as a matter of law and in fact constituted timely notice for the potential denial of coverage.

Declaratory Judgment Action Involving Pennsylvania MVFRL to be Heard by Pennsylvania State Courts, Not Federal Courts

In *Weilacher v. State Farm Mut. Auto. Ins. Co.*, 2010 U.S. Dist. LEXIS 121124 (W.D. Pa. Nov. 16, 2010), the United States District Court for the Western District of Pennsylvania remanded the insureds’ declaratory judgment action to the Pennsylvania state court following State Farm’s removal to federal court. The insureds sought a declaratory judgment that the limit of underinsured motorist coverage in their policy should be \$500,000 on each of the insureds’ two vehicles, that the amount of coverage should be stacked, and that State Farm must pay them the full amount of coverage under the policy. In remanding based on *Summy*, the court noted that, while federal courts

should invoke jurisdiction when federal questions or sovereign immunity issues arise, the only issues in the present case involved the Pennsylvania Motor Vehicle Financial Responsibility Law, a state law issue. The court cautioned that federal courts should refrain from hearing cases involving solely state law issues and “where there is a well-developed body of state law” and where the law is still evolving the issues are “better suited” for state court. Because the Pennsylvania courts have decided numerous MVFRL matters and stacking issues and that law is still evolving, the court determined the present case was better suited for the state court. Most troubling is that the court continued the trend of rejecting declaratory judgment actions involving insurance coverage matters even where no parallel state action exists, stating it “is a factor to be considered, [but] . . . it is neither a prerequisite nor a determinative factor in the decision-making process.”

Insured Required to Produce Claims and Underwriting Manuals in Discovery but Not Reinsurance Agreements and Reserves Information

In *TIG Ins. Co. v. Tyco Int’l, Ltd.*, 2010 U.S. Dist. LEXIS 120342 (M.D. Pa. Nov. 24, 2010), the United States District Court for the Middle District of Pennsylvania compelled an insurer to produce documents relating to claims and underwriting manuals but did not compel disclosure of reinsurance agreements and reserve information. The insured argued that these documents would assist in interpreting a prior acts endorsement in the insurance policy, which excluded “any claims of which the Named Insured had actual or constructive notice prior to the commencement of coverage under this policy.” The Court noted that while the claims and underwriting manuals were relevant in ascertaining whether ambiguity existed in the prior acts endorsement, the reinsurance agreements and reserves were too speculative in determining the policy’s meanings to merit production to the insured.

It is questionable whether this decision as to the manuals is in accord with Pennsylvania law. According to the opinion, the insured wanted the manuals to shed light on ambiguous policy language, i.e., to determine what the ambiguous language meant, not to prove that the policy was ambiguous. *Pappas v. UNUM Life Ins. Co.*, 856 A.2d 183 (Pa. Super. 2004) (“In the absence of ambiguity, Pappas’s call for additional discovery concerning the meaning of policy terms is wholly without merit.”)

No Duty to Defend or Indemnify Where Underlying Complaint Allegations Fail to Bring Claim Within Endorsement’s Coverage

In *Western Heritage Ins. Co. v. Darrah*, 2010 U.S. Dist. LEXIS 121533 (M.D. Pa. Nov. 17, 2010), the United States District Court for the Middle District granted declaratory relief in favor of an insurer that it had no duty to defend or indemnify the insured. Under the insurance policy’s premises/project endorsement, coverage was limited to auto dismantling and recycling operations. The allegations in the underlying complaint clearly alleged that the plaintiff in the underlying action was injured while repairing a vehicle in the insured’s repair/body shop. Because no allegations related to auto dismantling and recycling were made in the complaint, the claim fell outside the scope of coverage.

Excess Insurer Unable to Recover Reimbursement for Settlement Paid

In *Axis Specialty Ins. Co. v. The Brickman Group, Ltd.*, 2010 U.S. Dist. LEXIS 123050 (E.D. Pa. Nov. 18, 2010), the United States District Court for the Eastern District of Pennsylvania refused to allow an insurer to recover reimbursement for a settlement paid on behalf of an insured under either a breach of contract or unjust enrichment theory.

Axis Specialty Insurance Company provided \$5 million of coverage in excess of The Brickman Group's self-insured retention limit of \$250,000 and an excess policy issued by ACE American Insurance Company. In an underlying personal injury case, Axis' outside counsel negotiated a settlement which called for ACE to pay \$750,000 while Axis paid \$400,000 on Brickman's behalf. Following the settlement, Axis sought reimbursement from Brickman of the \$250,000 retained limit, which Brickman refused to pay.

After holding that Axis did not owe a duty to defend Brickman, the Court noted that unless an express provision in the insurance policy provides for reimbursement, an insurer cannot pursue a breach of contract claim to recover settlements. However, an insurer may bring an unjust enrichment claim against an insured for a settlement paid on an insured's behalf "if it is determined after the payment is made that the insurer was not obligated to make payment under the terms of the insurance policy." Relying on a Third Circuit opinion, *Essex Ins. Co. v. RMJC, Inc.*, 305 Fed. Appx. 749 (3d Cir. 2009), that allowed an insurer to seek reimbursement of a judgment paid on behalf of its insured, the court held that in order to recover under an unjust enrichment claim, the insurer must establish the following: "(1) it did not make the payment due to a mistake of law; (2) the insured was on notice at the time of the payment that the insurer disputed its obligation to pay; (3) it did not make the payment primarily to protect its own interest; and (4) permitting reimbursement under the circumstances presented would not upset the delicate incentive structure inherent in the insurer/insured relationship."

The Axis policy contained no explicit right to reimbursement to allow for a breach of contract claim. As to the unjust enrichment claim, the Court found that Axis was proceeding under a mistake of law as Axis had believed that Brickman's payments of defense costs could satisfy the self-insured retention and only later argued that it did not. Furthermore, Axis failed to send a reservation of rights letter or otherwise expressly advise Brickman that it disputed its obligation to pay part of the settlement. Additionally, despite Brickman's dissatisfaction with the terms of the settlement and its failure to include another party, Axis' own counsel settled the matter "because the settlement was in Axis's best interest." In finding that the settlement was for Axis' own benefit the court also noted that it was well within policy limits and cut off any potential for bad faith failure to settle. Since Axis failed to establish all of the elements to recover reimbursement under an unjust enrichment claim, judgment was entered in favor of Brickman.

While the driving force of this opinion may have been the fact that the excess carrier was not providing the defense, had no duty to defend and didn't advise the insured prior to settlement that the insured had to contribute the amount of the SIR, its final conclusion should be heeded as a word of caution to insurers who have provided a reservation of the right to deny coverage. The court stated, "Axis, however, settled the case over Brickman's objections, essentially threatening to contribute nothing to the settlement if Brickman did not cooperate. In doing so, Axis put Brickman in an impossible position." Although Axis had not indicated that the SIR was still in play, the court's comment seems to be indicating that an insurer cannot settle and make payment for the settlement while preserving coverage defenses without the insured's agreement to reimburse the payment if coverage for the claim does not actually exist.

Federal Court Permits Plaintiff's Late Jury Demand for Bad Faith Claim Where Insurer Made Demand Prior to Removal Even Though No Such Right Existed In State Court

In *Pratt v. Victoria Ins. Co.*, 2010 U.S. Dist. LLEXIS 120637 (E.D. Pa. November 12, 2010), the United States District Court for the Eastern District of Pennsylvania held that while Pennsylvania law does not provide for a right to a jury trial for bad faith insurance claims, the punitive damages remedy of 42 Pa. C.S. § 8371 triggers such a right under the Seventh Amendment in federal court. The Court found that the plaintiff was entitled to a jury trial even though the defendant's demand in state court before removal demanded what couldn't be had. Even if that demand were ineffectual, the plaintiff's late demand in federal court would not prejudice the defendant and would be allowed even though the defendant apparently no longer wanted a jury trial.