Insurance Coverage Update Pennsylvania

March 2009

PICADIO SNEATH MILLER & NORTON, P.C.
4710 U.S. STEEL TOWER
600 GRANT STREET
PITTSBURGH, PA 15219-2702
(412) 288-4000
FAX: (412) 288-2405

INSURANCE COVERAGE

BAD FAITH

CIVIL LITIGATION

COMMERCIAL LITIGATION

ENVIRONMENTAL LAW AND LITIGATION

INTELLECTUAL PROPERTY LITIGATION

Contents

Visit our Website at www.pennsylvaniabusinesslitigation.com or www.psmn.com

The Pennsylvania Supreme Court Holds Waiver of Stacking Provision Is Not Applicable

In *Generette v. Donegal Mutual Ins. Co.*, 957 A.2d 1180 (Pa. 2008), the Pennsylvania Supreme Court addressed the interaction between Section 1733 of the Motor Vehicle Financial Responsibility Law ("MVFRL"), which governs the priority of recovery of uninsured ("UM") or underinsured ("UIM") insurance, and the MVFRL's provision for the waiver of stacking of UIM coverage (75 Pa. C.S. § 1738). The Court held that the waiver of stacking provision did not apply because Appellant did not qualify as an insured as defined in Section 1702 of the MVFRL.[1]

On April 29, 1997, Appellant was injured while riding as a passenger in a motor vehicle that collided with a third-party tortfeasor's vehicle. Appellant recovered $25,000 under the tortfeasor's liability insurance policy. She also recovered $50,000 from Nationwide which provided UIM coverage for the car in which she was a passenger. Thereafter, Appellant sought coverage for her remaining claims under her own policy with Appellee Donegal for UIM coverage. Appellant had contracted for $35,000 of UIM coverage and waived her ability to stack her coverage in exchange for reduced premiums. Donegal denied coverage based upon the waiver of stacking provision

After Donegal denied Appellant's claim, she filed a declaratory judgment action and a motion for summary judgment in state Court. The trial Court held that the waiver of stacking provision was valid and that the "other insurance" provision was valid and enforceable and not against public policy. The Superior Court reversed the trial Court but latter affirmed it *en banc*.

Appellant argued the stacking waiver language was limited to policies for an "insured" as defined by Section 1702 of the MVFRL, which did not define a guest passenger as an insured. Instead, contended Appellant, the case was governed by the MVFRL's provision for priority of recovery, 75 Pa. C.S. § 1733, which she properly followed. Additionally, Appellant argued that the "other insurance" provision was in violation of public policy because it resulted in gap coverage rather than excess coverage and was invalid.

Donegal contended that stacking, and the waiver thereof provided in Section 1738 of the MVFRL, applied to those who recover insurance as guest passengers as well as those defined by the MVFRL. Donegal argued that Appellant's position on the "other insurance" provision lacked merit because it was based upon distinguishable case law which did not consider multiple UIM providers, but instead involved the interaction of the tortfeasor's liability coverage and the primary UIM coverage.

The Court felt bound to apply the specific definition of "insured" provided in Section 1702 absent any indication from the Legislature to the contrary. The Court reached this conclusion even though Section 1733(a) suggests that guest passengers are covered by most insurance policies, given that the first priority UIM coverage is the policy covering the vehicle occupied, regardless of whether the injured person is an insured. However, the Court left the resolution of this issue to the Legislature. ♦

[1] An "Other Insurance" provision was also held to be invalid as a matter of public policy.

The Pennsylvania Supreme Court Holds the MVFRL Does Not Require Exhaustion of Primary UIM Benefits Before Secondary Coverage Is Implicated

On November 19, 2008, the Pennsylvania Supreme Court issued an opinion addressing whether or not Pennsylvania's MVFRL requires the exhaustion of primary UIM benefits before secondary UIM coverage is implicated. In *Nationwide Ins. Co. v. Schneider*, No. 11 MAP 2007, 2008 Pa. LEXIS 2047 (Pa. Nov. 19, 2008), the Court took a compromise approach to this issue and held that while exhaustion is not required, the insured must give the insurer a credit for the amount that that "was left on the table." The Court also considered the enforceability of a consent-to-settle clause in a UIM policy. The Court refused to enforce the clause but only under the circumstances of this case.

The facts of the case involved a motor vehicle accident between Appellee, and another individual. Appellee settled with the tortfeasor's insurer at the $15,000 limit. Appellee's employer maintained a policy which included UIM coverage subject to a one million dollar limit. Appellee pursued a claim for UIM benefits under this policy, and the insurer, Granite State Insurance Company, agreed to pay a $750,000, which was $250,000 less than the policy limit.

Two months later, Appellee sought secondary UIM benefits under his personal automobile insurance policy issued by Appellant Nationwide, which had limits of $200,000. The Nationwide policy contained an exhaustion clause providing that "[n]o payment will be made until the limits of all other auto liability insurance and bonds that apply have been exhausted by payment." The policy also included a "consent-to-settle" provision which stated that the insured must "preserve and protect Nationwide's right to subrogate against any liable party" and obtain Nationwide's written consent to settle any legal action brought against a liable party or release any party.

Nationwide denied Appellee's claim and filed a declaratory judgment action seeking a determination that it had no obligation to pay secondary UIM benefits to Appellee due to his failure to exhaust his primary UIM benefits and his failure to obtain Nationwide's consent to settle his primary UIM claims as required by the policy. In addition, Nationwide argued that exhaustion was required not only by the terms of the policy, but also under the MVFRL. Section 1733 of the MVFRL provides the order in which policies apply when more than one policy is at issue.

In response to Nationwide's motion for summary judgment, Appellee argued that there was no need for exhaustion of primary UIM benefits because he extended a credit to Nationwide for the $250,000 that Granite State did not pay under its policy limits, citing *Boyle v. Erie Ins. Co.*, 656 A.2d 941 (Pa. Super. 1995). In addition, Appellee argued that under *Nationwide Mutual Ins. Co. v. Lehman*, 743 A.2d 933 (Pa. Super. 1999), Nationwide was required to establish that its interests were prejudiced by Appellee's failure to obtain its consent to settle.

The Court of common pleas awarded summary judgment in Nationwide's favor. The Superior Court reversed, and the Supreme Court granted allocator.

The Pennsylvania Supreme Court stressed that its purpose is to give effect to the intent of the Legislature. It agreed that Section 1733 does not mention exhaustion of policy limits. The Court also rejected the notion that it necessary to establish an exhaustion requirement for Section 1733's priority of recovery scheme. Instead, the Court reasoned that the priority of recovery scheme was necessary to encourage prompt recovery for injured Plaintiffs. According to the Court, it also furthers Section 1733's policy of encouraging voluntary settlements. While recognizing that traditional insurance is subject to exhaustion, the Court observed that UM and UIM insurance is not traditional insurance as it has evolved in Pennsylvania. Thus, the Court refused to infer that the legislature intended to implement an unstated exhaustion requirement.

With respect to contractual exhaustion, the Court addressed whether such requirements were invalid on account of public policy. The Court noted that Pennsylvania Courts have disfavored strict enforcement of such clauses. Additionally, the Court noted it usually considers the Pennsylvania Insurance Department's opinion regarding policy language but no such opinion was given in this case. The department took the position that the case did not involve issues within its regulatory expertise, and the case did not involve issues directly impacting widespread consumer interests. The Court then concluded that in absence of express legislative direction or administrative agency involvement, the Superior Court's "credit-for-limits" approach in *Boyle* was a reasonable compromise and adopted this approach as its own.

On the second issue regarding the consent to settle clause, Nationwide conceded that demonstration of prejudice was required as a prerequisite to enforcement. Nationwide argued that the prejudice it

Continued on Page 3

***Nationwide Ins. Co. v. Schneider* – From Page 2**

suffered was the gap between the settlement amount and the available first-priority coverage because it could not recoup the gap from the primary UIM insurer.

The Court rejected Nationwide's arguments. The Court found that Nationwide failed to present evidence of actual prejudice. The Court noted that Nationwide stated that "it will never really know what might have occurred [if given the opportunity to consent]," although "[i]t is reasonable to assume that consent would not have been forthcoming." Thus, the Court found Nationwide's prejudice arguments to be too abstract and refused to enforce the consent to settle provision. In a footnote, the Court stressed that because Nationwide conceded the prejudice requirement applied to it, it was not deciding that a showing of prejudice is required of all insurers in this situation. ♦

Court Rules That Bad Faith Claim Is Not Preempted by the MVFRL

A judge for the United States District Court for the Middle District of Pennsylvania has held that Plaintiff's allegations of the abuse of the peer review process are outside the scope of Section 1797 of the MVFRL, and therefore, refused to dismiss Plaintiff's claims of bad faith pursuant to Pennsylvania's bad faith statute, 42 Pa. C.S. § 8371 ("Section 8371" or "Bad Faith Statute"). See *Perkins v. State Farm Ins. Co.*, No. 3:08-CV-1084, 2008 U.S. Dist. LEXIS 101931 (M.D. Pa. Dec. 16, 2008).

Plaintiff was struck by a motor vehicle while she was walking in a grocery store parking lot and was injured. At the time, Plaintiff was insured under an automobile policy issued by State Farm which provided first-party medical coverage in the amount of $50,000. Plaintiff received medical treatment for her injuries, including chiropractic treatment. State Farm paid Plaintiff for her treatment for almost three years. However, State Farm then sent a letter to Plaintiff's chiropractor indicating that it would not pay for any further treatment of Plaintiff and requested that the chiropractor reimburse State Farm $3,590.86, with 12% interest, that it had paid for treatment of Plaintiff for a 17-month period. State Farm took this action based upon a peer review by another chiropractor, who opined that Plaintiff's chiropractor's treatment of Plaintiff was not reasonable or necessary. MVFRL provided for the retention of a "peer review organization" ("PRO") for the purpose of confirming treatment is necessary.

Plaintiff filed suit asserting causes of action for breach of contract and statutory bad faith, among others. State Farm filed a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6). With respect to the bad faith claim, State Farm argued that Plaintiff's bad faith claim had to be dismissed because the MVFRL provided the exclusive remedy for Plaintiff's claim and preempted her claim under the Bad Faith Statute.

The Court noted at the outset that the Pennsylvania Supreme Court has not addressed whether the MVFRL preempts Section 8371, and the issue has produced an array of conflicting opinions in Pennsylvania's state and federal Courts. Some Courts faced with the issue have held that the two statutes do not conflict. Others have held to the contrary. However, the Court explained there is another line of decisions which rely heavily upon *Schwartz v. State Farm Ins. Co.*, Civil Action No. 96-160, 1996 U.S. Dist. LEXIS 4994 (E.D. Pa. Apr. 18, 1996) for the proposition that while Section 8371 is preempted by the MVFRL where an insured challenges only the denial of first-party medical benefits, an insured may raise a Section 8371 claim based upon an insurer's bad faith conduct which goes beyond the scope of Section 1797(b), such as claims involving contract interpretation or claims that the insurer did not properly invoke or follow the PRO process. The *Perkins* Court found the reasoning of this line of cases to be persuasive.

Applying the *Schwartz* line of cases, the Court found that some of the allegations made in support of Plaintiff's bad faith claim, such as State Farm's alleged failures to conduct a reasonable investigation, were nothing more than a challenge to the denial of first-party benefits and would fall under Section 1797. However, the Court held that Plaintiff's bad faith claim was also premised upon the allegations that State Farm engaged a PRO that performed substantial work for State Farm and thus had a financial interest in providing a biased determination, and that the PRO had continuously provided negative peer review reports to State Farm to maintain their business. The Court concluded that these allegations of abuse of the PRO process were not within the scope of Section 1797 and that Courts have repeatedly held that such allegations state a claim under Section 8371. Therefore, while the Court stated Plaintiff's allegations were thin, the Court held that they were sufficient to state a claim under Section 8371. ♦

The Third Circuit Reduces Punitive Award to a One-to-One Ratio in Bad Faith Case

In a non-precedential opinion,[2] the Chief Judge of the Third Circuit has held in the context of a bad faith claim that where a Defendant's conduct involves only a moderate degree of reprehensibility and the Plaintiff wins a substantial compensatory award, the punitive damages should be awarded on a one-to-one ratio. *Jurinko v. The Medical Protective Co.*, Nos. 06-3519 and 06-3666, 2008 U.S. App. LEXIS 26263 (3d. Cir. Dec. 24, 2008). While the Third Circuit does not consider this to be binding precedent, it is an indication that at least the Chief Judge of the Third Circuit is in favor of limiting large punitive damage awards.

In this case, a jury awarded Plaintiff compensatory damages against the insurer on a bad faith claim in the amount of $1,658,345 and punitive damages in the amount of $6,250,000. The insurer challenged the award on constitutional grounds, i.e. was the award of punitive damages so grossly excessive that it violated the Due Process Clause of the Fourteenth Amendment. The Chief Judge examined three factors: (1) the degree of reprehensibility; (2) the ratio between the harm and the punitive damage award; and (3) the disparity between the punitive damages award and the civil penalties. The Court found a moderate degree of reprehensibility, a substantial compensatory damage award and a large disparity between the award and the civil penalties available under Pennsylvania's Unfair Insurance Practices Act. Moreover, the Chief Judge cited *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 123 S. Ct. 1513, 155 L. Ed. 2d 585 (2003) in which the U.S. Supreme Court stated that "[w]hen compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee." Based upon the three factors and *Campbell*, the Court reduced the award to reflect a one-to-one ratio. ♦

---

[2] Under the Third Circuit's Internal Operative Procedure 5.7, the Third Circuit does not cite to its "non-precedential" opinions as authority because they do not circulate such opinions to the full Court. However, Federal Rule of Appellate Procedure 32.1(a) provides that a Court may not prohibit or restrict the citation of federal judicial opinions, order, judgments or other written dispositions that have been designated as "non-precedential."

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. ♦

Insurance Coverage Update
Pennsylvania

Picadio Sneath Miller & Norton, P.C.
4710 U.S. Steel Tower
600 Grant Street
Pittsburgh, PA 15219