Insurance Coverage Update Pennsylvania

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Insurer Cannot Obtain Reimbursement of Attorneys' Fees Despite Finding of No Coverage

In American & For. Ins. Co. v. Jerry's Sport Center, Inc., 948 A.2d 834 (Pa. Super. 2008), Pennsylvania's first-level appellate court determined that an insurer is not entitled to be reimbursed for attorneys' fees incurred defending an insured under a reservation of rights where it is ultimately decided the insurer had no duty to defend. There, Jerry's Sport Center, Inc. purchased a commercial liability policy from Royal Insurance. The NAACP sued Jerry's and other firearm dealers for negligence in marketing and distributing handguns. After defending Jerry's for three months subject to an explicit reservation of rights, Royal informed Jerry's that it had no duty to defend or indemnify Jerry's and would commence a declaratory relief action. Royal continued to advance the costs of defense in the NAACP action but still reserved the right to recoup the costs if successful in the coverage suit. The defense firm hired by Royal eventually succeeded in obtaining summary judgment in favor of Jerry's, with legal bills totaling $317,540.29.

In the declaratory judgment action, the trial court held that the NAACP suit did not allege "bodily injury" as defined in the policy, and thus there was no coverage. Royal then filed a motion seeking reimbursement of defense fees. The trial court granted the motion finding an implied contract between the parties entitling the insurer to recoup the costs expended in defending the claim.

On appeal, the Superior Court recognized that courts are split in the approach to this issue. The majority allow reimbursement based on the theories of unjust enrichment and an implied contract created through a reservation of rights letter. However, a minority of jurisdictions, including the U.S. Court of Appeals for the Third Circuit, hold that insurers cannot recoup under these circumstances absent an express provision allowing so in the written insurance contract. The Superior Court found the minority position persuasive based on the policy language, principles of Pennsylvania law concerning an insurer's duty to defend and the benefits an insurer receives by defending under a reservation of rights.

The policy provided Royal with the right and duty to defend covered claims and Pennsylvania law requires an insurer to defend an insured even if it ultimately will not owe indemnity where the complaint alleges a claim potentially covered by the policy. Furthermore, Royal benefited by undertaking the defense because it preserved its right to control the defense and to take actions to mitigate any future indemnification responsibilities. Although not stated by the Court, Royal's defense under a reservation of rights also protected it against a potential bad faith claim if it were ultimately determined that Royal had a duty to defend.

Consequently, the court rejected the argument that the reservation of rights letter created an implied contract and that Jerry's was unjustly enriched by the defense. Rather, the court found that undertaking a defense while seeking to recoup the fees expended was an attempt by Royal to unilaterally modify the written insurance contract. The court emphasized that an insurer could retain its right to seek reimbursement of defense costs if it is later determined that the underlying claim is not covered by the policy, by including such a provision in its insurance contract.

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The Court's opinion is troubling to the extent it suggests that an insurer has a "duty" to defend borne out of its decision to reserve rights. Rather, the decision to defend is an exercise of a right, and any "duty" flows solely from a contractual provision requiring a defense for claims potentially covered. The Court, in an earlier appeal, so recognized by affirming the trial court's determination that no duty to defend existed. ♦

Federal District Court Holds That Filing a Declaratory Judgment Action Is a Denial of a Claim and May Constitute Bad Faith

In a decision that is contrary to Pennsylvania precedent, Gideon v. Nationwide Mut. Fire Ins., 2008 U.S. Dist. LEXIS 26729 (W.D. Pa. 2008), a federal judge held that providing a defense under a reservation of rights and filing a declaratory judgment action constitutes a denial of an insured's claim, subjecting the insurer to a bad faith claim.

Nationwide, Gideon's homeowner's insurer, provided a defense for an underlying suit alleging negligence, battery and punitive damages, but did so under a reservation of rights based upon the expected or intended exclusion. Nationwide then filed a declaratory judgment action seeking a declaration that Gideon acted intentionally in firing a gun at Fitzsimmons and in causing bodily harm.

After denial of its summary judgment motion, Nationwide amended the complaint to assert a new theory that there was no "occurrence" as defined in the policy. The declaratory judgment action proceeded to trial, and the jury found Gideon did not intend to shoot Fitzsimmons.

Gideon then filed suit alleging Nationwide breached its contract by failing to indemnify, failing to promptly settle, failing to perform a reasonable and timely evaluation and frustrating the resolution of the claim thereby forcing Gideon to incur attorney's fees and costs in defending the declaratory judgment action and in monitoring the Underlying Suit. Gideon also asserted a statutory bad faith claim against Nationwide alleging improper investigation, processing and analysis of the claim. Even though Nationwide never denied any benefit, the insured averred that after Nationwide investigated and knew the facts of the underlying suit from a review of deposition transcripts, it knew it could not prevail in the declaratory judgment action but nevertheless continued in its efforts to avoid indemnification and defense by pursuing the action. Nationwide moved to dismiss the breach of contract count because it had indemnified plaintiff by settling the Underlying Suit, and thus there was no failure to settle resulting in actual damages as a consequence of any alleged delay. Nationwide also moved to dismiss the bad faith count because it provided a defense in the underlying suit under a reservation of rights and filed the declaratory judgment action to clarify its coverage obligations. Further, Nationwide promptly settled the Underlying Suit following the declaratory judgment trial, and it never denied any benefits to plaintiff.

The court denied the 12(b)(6) motion as to both counts, treating the issue as one unresolved by the Pennsylvania Supreme Court. Without discussing any Pennsylvania case law, the court relied upon Highlands Ins. Group v. Van Buskirk, 1999 U.S. Dist. LEXIS 8532 (E.D. Pa. 1999), for the proposition that an insurer "can be held liable for attorney fees incurred by the insured in defending the declaratory judgment action." Therefore, the court held, defending under a reservation of rights while pursuing a declaratory judgment action is a denial of a claim. The court reasoned that "[t]o hold otherwise would allow an insurance company to treat its insured unfairly, such that its insured is forced to hire an attorney in order to receive the benefits of his insurance policy."

Thus, the court concluded that plaintiff had set forth allegations in the complaint which if proven by clear and convincing evidence would establish a bad faith claim under 42 Pa. C.S. § 8371. This conclusion was based upon the court's finding that the Superior Court has held that § 8371 is not restricted to conduct in denying a claim but also extends to the insurer's investigative practices.

This opinion is troubling on several levels. First, it fails to recognize that the Pennsylvania Supreme Court has clarified that a denial of benefits is required for a statutory bad faith claim. Toy v. Metropolitan Life Ins. Co., 928 A.2d 186 (Pa. 2007). Thus, the Superior Court cases the court relied upon regarding investigative practices are no longer good law if an actual denial of benefits is not involved. Second, the courts have long recognized that an insurer can protect itself against bad faith by defending under a reservation of rights and may file a declaratory judgment action rather than risk giving an outright denial. Cay Divers, Inc. v. Raven, 812 F.2d 866, 871 (3d Cir. 1987) (defense under reservation does not breach duty to defend); Stidham v. Millvale Sportsmen's Club, 618 A.2d 945 (Pa. Super. 1992) (noting insurer could have filed declaratory judgment action to determine obligations rather than denying

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defense). Although the court makes a broad pronouncement that defending under reservation and filing a declaratory judgment action is a denial, its holding seems to be based on the perceived injustice to the insured when its insurer *continues* a declaratory judgment action after it becomes clear that such pursuit is no longer well founded. As former Pennsylvania Supreme Court Chief Justice Cappy noted in dissent to dismissal of the appeal in Hollock v. Erie Ins. Exch., 903 A.2d 1185 (Pa. 2006), the courts have other methods of punishing an insurer for litigation conduct. ♦

Worker's Compensation Exclusion in UIM Coverage Upheld

Pennsylvania's Commonwealth Court recently held that a worker's compensation exclusion did not violate Pennsylvania's Motor Vehicle Financial Responsibility Law ("MVFRL") or public policy, and thus the exclusion was enforceable. Heller v. Pennsylvania League of Cities and Municipalities, 950 A.2d 362 (Pa. Commw. 2008).

In Heller, plaintiff was injured in an automobile accident during the course of his employment as a police officer. Plaintiff obtained the other driver's policy limits and also received worker's compensation benefits. Plaintiff sought underinsured motorist benefits under the Borough's policy with defendant Pennsylvania League of Cities and Municipalities ("Penn PRIME").

Penn PRIME denied coverage based upon an exclusion barring coverage for "[a]ny claim by anyone eligible for workers compensation benefits that are the statutory obligation of the Member." The parties agreed that the provision applied to the facts. However, the insured argued that the exclusion violated public policy. The trial court agreed, and Penn PRIME appealed.

In reversing the trial court, the Commonwealth Court examined Pennsylvania statutes and case law. At the outset, the court noted that the MVFRL previously contained a provision expressly stating that "[t]he coverages required by this Act shall not be made subject to an exclusion or reduction in amount because of any worker's compensation benefits payable as a result of the same injury." 75 Pa. C.S. § 1735. The court then examined case law decided before and after the 1993 repeal of § 1735 and concluded that none of the cases decided the exact issue before this court.

The court found no specific provisions in either the MVFRL or the Worker's Compensation Act which prohibit this type of exclusion from UIM coverage. Moreover, the court found that the conflicting public policy considerations fell on the side of the insurer. In reaching this conclusion, the court recognized that the purpose of the MVFRL is to reduce increasing insurance costs and a court should not act as a super-legislature in redrafting contract documents on the sole basis of outcomes that may be desired for the general good.

This case is inconsistent with an earlier Superior Court opinion which invalidated a workers' compensation exclusion. Harper v. Providence Wash. Ins. Co., 753 A.2d 282 (Pa. Super. 2000). However, the Superior Court opinion erroneously felt bound by a Supreme Court decision despite the fact that the Supreme Court had construed workers' compensation immunity, not an exclusion. Also, the Supreme Court has indicated disfavor for invalidating policy provisions based on public policy except in the rarest and clearest of cases. Burstein v. Prud. Prop. & Cas. Ins. Co., 809 A.2d 204 (Pa. 2002). Thus, we believe the Commonwealth Court's decision is the better-reasoned of the two. ♦

Insurer Does Not Have Standing to Object to Plan of Reorganization Where Plan Is "Insurance Silent"

In Hartford Acc. & Indem. Co. v. North American Refractories Cos., Civil Action No. 07-1750 (W.D. Pa. 7/25/2008), a district judge affirmed a bankruptcy judge's holding that an insurer did not have standing to object to a Plan of Reorganization because the Plan was not only insurance neutral, it was "insurance silent."

The Plan for North American Refractories Companies (NARCO) established an asbestos trust to be funded by an equity share in the reorganized Debtor and cash payments from Honeywell, a separate entity. Honeywell contributed to the trust and the Plan channeled Honeywell's asbestos personal injury claims to the trust. Hartford was one of Honeywell's excess insurers. The court noted that Honeywell's obligations to contribute to the trust were not dependent on its insurance proceeds.

The court determined that Hartford did not meet the main test for standing or party in interest status. Constitutional standing requires, *inter alia*, an actual injury causally connected to the alleged offending conduct and prudential standing will not be found if the alleged injury is "outside the zone of interest the statute was designed to protect." Slip op. at 4 (citations omitted). Finally, to be a party in interest requires an interest directly or adversely affected by the bankruptcy proceeding. Id. Because the Plan was not dependent on insurance and Hartford conceded that confirmation of the Plan would not create any liability for it or take away

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any of Hartford's defenses under the policies, Hartford could not claim an injury caused by the Plan. Thus, it lacked standing. ♦

Injured Pedestrian May Sue Insurer Directly for First-Party Benefits

In Glover v. State Farm Mut. Auto. Ins. Co., 950 A.2d 335 (Pa. Super. 2008), the court addressed the propriety of an injured pedestrian's suit against the driver's insurance company. The pedestrian sued State Farm alleging that it failed to pay fully the first-party benefits to which the pedestrian was entitled. The trial court granted summary judgment in favor of State Farm on the bases that the claim was governed and barred by a two-year statute of limitations and that the claim against State Farm had to go through the insured who was not properly joined.

The Superior Court reversed on both grounds. The court held that the correct statute of limitations was four years, not two, and that the statute had not run. The court relied on the Motor Vehicle Financial Responsibility Law which states that a suit for first-party benefits "shall be commenced within four years from the date of the accident . . . . [or] within four years from the date of the last payment." 75 Pa. C.S. § 1721(a). Because State Farm had paid some first-party benefits to the pedestrian, the statute ran from the date of the last payment. As it had not yet even been four years from the date of the accident, the claim was not time barred.

The court also disagreed that the pedestrian had to sue State Farm through a claim against the driver. (State Farm had not raised this argument.) The court acknowledged that the law does not clearly state who the proper defendant is, but reasoned that first-party benefits do not require the existence of a tortfeasor, i.e., a driver does not have to be negligent for a pedestrian or any injured party to be entitled to first-party benefits. Therefore, suit against the insured is not necessary as in a third-party claim. Furthermore, the claim for first-party benefits is allowed by statute and it "appears that the legislature meant such claims to be brought directly against the insurer." ♦

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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