

## Pennsylvania

### REGULATORY LIMITS ON CLAIMS HANDLING

#### Timing for Responses and Determinations

The Pennsylvania Administrative Code, Title 31, Insurance, Chapter 146, Subchapter A, Unfair Claim Settlement Practices, defines certain minimum standards which, if violated with a frequency that indicates a general business practice, will be deemed to constitute unfair claims settlement practices. Section 146.5. "Failure to acknowledge pertinent communications" provides that an insurer shall acknowledge receipt of the notice of a claim within 10 working days of receiving notification. Section 146.6. "Standards for prompt investigation of claims" provides that an insurer shall complete investigation of a claim within 30 days after notification of claim, unless the investigation cannot reasonably be completed within the time. If the investigation cannot be completed within 30 days, and every 45 days thereafter, the insurer shall provide the claimant with a reasonable written explanation for the delay and state when a decision on the claim may be expected.

Prompt settlement of a first-party claim requires that an insurer advise the insured of its decision within 15 working days after receipt of a properly executed proof of loss. *See, Willow Inn, Inc. v. Public Service Mut. Ins. Co.*, 399 F.3d 224,229 (3d Cir. 2005)(citing 31 Pa. Code § 146.7(a)(1)).

Pursuant to Section 146.7 (e), insurers may not continue negotiations for settlement of a claim directly with a claimant who is neither an attorney nor represented by an attorney until the rights of the claimant may be affected by a statute of limitations or a policy or contract time limit, without giving the claimant written notice that the time limit may be expiring and may affect the rights of the claimant. The notice shall be given to first-party claimants 30 days, and to third-party claimants 60 days, before the date on which the time limit may expire.

#### Standards for Determination and Settlements

The Unfair Insurance Practices Act ("UIPA"), 40 P.S. §§ 1171.1 to 1171.15, prohibits certain unfair and deceptive conduct by insurers. The Insurance Commissioner enforces the statute. Section 1171.4, titled "Unfair methods of competition and unfair or deceptive acts or practices prohibited" provides:

No person shall engage in this state in any trade practice which is defined or determined to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance pursuant to this act.

Section 5 of the Act, 40 P.S. § 1171.5 defines "unfair methods of competition" and "unfair or deceptive acts or practices". Subsection (10) identifies unfair claim settlement or compromise practices:

10) Any of the following acts if committed or performed with such frequency as to indicate a business practice shall constitute unfair claim settlement or compromise practices.

- Misrepresenting pertinent facts or policy or contract provisions relating to coverages at issue.
- Failing to acknowledge and act promptly upon written or oral communications with respect to claims arising under insurance policies.
- Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies.
- Refusing to pay claims without conducting a reasonable investigation based upon all available information.
- Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed and communicated to the company or its representative.
- Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which the company's liability under the policy has become reasonably clear.
- Compelling persons to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts due and ultimately recovered in actions brought by such persons.
- Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.
- Attempting to settle or compromise claims on the basis of an application which was altered without notice to or knowledge or consent of the insured of such alteration at the time such alteration was made.
- Making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which payments are being made.
- Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants to induce or compel them to accept settlements or compromises less than the amount awarded in arbitration.
- Delaying the investigation or payment of claims by requiring the insured, claimant or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.
- Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage or under other policies of insurance.
- Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.
- Refusing payment of a claim solely on the basis of an insured's request to do so unless:

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- The insured claims sovereign, eleemosynary, diplomatic, military service, or other immunity from suit or liability with respect to such claim;
- The insured is granted the right under the policy of insurance to consent to settlement of claims; or
- The refusal of payment is based upon the insurer's independent evaluation of the insured's liability based upon all available information.

The Pennsylvania Supreme Court has held that the system of sanctions established under the UIPA need not be supplemented by a judicially created cause of action to deter bad faith conduct. *D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 431 A.2d 966 (Pa. 1981). In *D'Ambrosio*, the insured's cause of action in tort for bad faith in denying a property damage claim was dismissed.

The Pennsylvania Supreme Court has acknowledged that it has not addressed the question whether a violation of the UIPA is relevant to a claim of bad faith under Pennsylvania's bad faith statute, 42 Pa.C.S.A. § 8371. See, *Toy v. Metro. Life Ins. Co.*, 928 A.2d 186, n. 17 (Pa. 2007). The Pennsylvania Superior Court has stated that a trial court may consider the alleged conduct constituting violations of the UIPA and the Department of Insurance Regulations in determining whether the insurer acted in bad faith pursuant to 42 Pa.C.S.A. § 8371. *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228, 1233 (Pa. Super. 1984).

In addressing an insured's claim, a life, health, or accident insurer is no longer limited to consideration of statements contained in documents attached to the policy itself. Rather, the relevant statute only requires that a copy of the application or other materials be provided to the insured if the insurer intends to rely on them in deciding the claim. See *Prousi v. Unum Life Ins. Co. of Am.*, 77 F. Supp.2d 665, 668 (E.D.Pa. 1999), affirmed without published opinion, 251 F.3d 154 (3rd Cir. 2000). The relevant statute provides as follows:

No statement made by an insured shall be received into evidence in any controversy between the parties to, or a claimant or claimants interested in, a life insurance or health and accident insurance policy unless a copy of the document containing the statement is or has been furnished to such person or those legally acting on his behalf in the controversy.

40 P.S. § 441.

## PRINCIPLES OF CONTRACT INTERPRETATION

Under Pennsylvania law, the interpretation of an insurance contract regarding the existence or non-existence of coverage is generally performed by the court. *Minnesota Fire and Cas. Co. v. Greenfield*, 855 A.2d 854, 861 (Pa. 2004). *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 897 (Pa. 2006) ("The interpretation of an insurance contract is a question of law that we will review de novo").

The court's purpose in interpreting insurance contracts is to ascertain the intent of the parties as manifested by the terms used in the written insurance policy. When the language of the policy is clear and unambiguous, the court gives effect to that language. Alternatively, when a provision in the policy is ambiguous, the policy is to be construed in favor of the insured to further the contract's prime purpose of indemnification and against the insurer, as the insurer drafts the policy, and controls coverage. *Fourth Street, Inc. v. Investors Ins. Group*, 879 A.2d 166, 171 (Pa. 2005).

Contractual language is ambiguous "if it is reasonably susceptible of different constructions and capable of being understood in more than one sense." *Hutchison v. Sunbeam Coal Co.*, 519 A.2d 385, 390 (Pa. 1986). It is not a

question to be resolved in a vacuum. Rather, contractual terms are ambiguous if they are subject to more than one reasonable interpretation when applied to a particular set of facts. The court will not distort the meaning of the language or resort to a strained contrivance in order to find an ambiguity. *Madison Constr. Co. v. Harleysville Mut. Ins. Co.*, 735 A.2d 100, 106 (Pa. 1999).

## CONTRACT INTERPRETATION

### Common Issues

#### 1. Faulty Workmanship as an “Occurrence” [What is the state of the common law in your state on this subject?]

With a few exceptions in the Pennsylvania intermediate appellate court, state and federal courts in Pennsylvania applying Pennsylvania law continue to follow the Pennsylvania Supreme Court holding in *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Insurance Co.*, 589 Pa. 317; 908 A.2d 888, 899 (2006), when addressing claims of faulty workmanship and a definition of “occurrence” as an accident in a general liability policy. In *Kvaerner*, the Pennsylvania Supreme Court held:

“[T]he definition of “accident” required to establish an “occurrence” under the policies cannot be satisfied by claims based upon faulty workmanship. Such claims simply do not present the degree of fortuity contemplated by the ordinary definition of “accident” or its common judicial construction in this context. To hold otherwise would be to convert a policy for insurance into a performance bond. We are unwilling to do so, especially since such protections are already readily available for the protection of contractors.”

See also *Millers Capital Ins. Co. v. Gambone Bros. Dev. Co.*, 941 A.2d 706, 713 (Pa. Super. Ct. 2007) (“[N]atural and foreseeable acts ... which tend to exacerbate the damage, effect, or consequences caused ab initio by faulty workmanship also cannot be considered sufficiently fortuitous to constitute an ‘occurrence.’ ”); *Specialty Surfaces Intern., Inc. v. Continental Cas. Co.*, 609 F.3d 223, 239 (3d Cir. 2010) (finding that “damages that are a reasonably foreseeable result of the faulty workmanship” are not an occurrence under a commercial general liability policy).

There are two post-*Kvaerner* reported intermediate appellate cases: (1) *Indalex Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 83 A.3d 418 (Pa. Super. 2013); and (2) *Pa. Mfr. Indem. Co. v. Pottstown Indus. Complex LP*, 215 A.3d 1010 (Pa. Super. 2019), which draw a distinction between damage to the agreed-upon work product and damage to property other than the work product. In those two cases, the Superior Court found that faulty workmanship was a covered “occurrence” because the faulty workmanship caused damage to property other than the work product itself. In *Indalex*, the insureds allegedly supplied windows and doors that “were defectively designed or manufactured and resulted in water leakage that caused physical damage, such as mold and cracked walls, in addition to personal injury”. In *Pa. Mfr. Indem. Co.*, a tenant sued the insured landlord for breach of contract alleging negligent failure to maintain and repair the roof which led to extensive damage to inventory stored at the leased premises as a

result of four rainstorms over a period of three years. The Pennsylvania Superior Court distinguished *Indalex* and *Pa. Mfr. Indem. Co.* from *Kvaerner* and cases that followed it, stating in *Pa. Mfr. Indem. Co.* that “[t]hese precedents, however, do not hold that the fact that liability is based on failure to properly perform contractual duties precludes the existence of an ‘occurrence’ where the claim is for damage to property not supplied by the insured and unrelated to what the insured contracted to provide.”

The Third Circuit Court of Appeals has not agreed with that distinction. *See, Sapa Extrusions, Inc. v. Liberty Mut. Ins. Co.*, 939 F.3d 243 (3d Cir. 2019) (“Kvaerner’s logic ... is not limited to situations in which only the work product itself is damaged. On the contrary, claims for faulty workmanship – in other words, the failure to provide a product as agreed—are too foreseeable to be considered an accident, even if a faulty product damages property other than itself.”).

In addition, the Third Circuit in *Sapa* noted that in *Indalex*, the definition of “occurrence” in the policy included additional language: “an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage neither expected nor intended from the standpoint of the Insured.” In *Sapa*, there were policies that included similar language in an expanded definition of “occurrence” and the Third Circuit Court stated that whether there was an “occurrence” under policies with a definition that includes “expected or intended” language turns on the insured’s subjective intent.

## 2. **Does Your State Have an Anti-Indemnity Statute? [And if so, does it have any notable peculiarities?]**

As of March 2024, the only Anti-Indemnity Statute in Pennsylvania is limited in scope and is found at 68 P.S. Sec. 491 titled “Preparation of plans; giving or failure to give directions; indemnity agreement”, which states:

Every covenant, agreement or understanding in, or in connection with any contract or agreement made and entered into by owners, contractors, subcontractors or suppliers whereby an architect, engineer, surveyor or his agents, servants or employees shall be indemnified or held harmless for damages, claims, losses or expenses including attorneys’ fees arising out of: (1) the preparation or approval by an architect, engineer, surveyor or his agents, servants, employees or invitees of maps, drawings, opinions, reports, surveys, change orders, designs or specifications, or (2) the giving of or the failure to give directions or instructions by the architect, engineer, surveyor or his agents, servants or employees provided such giving or failure to give is the primary cause of the damage, claim, loss or expense, shall be void as against public policy and wholly unenforceable.

There have been efforts in the Pennsylvania Legislature to amend and broaden the statute, the latest effort being House Bill 1164 introduced May 18, 2023, which is described by its author as legislation that would “void any provision in construction contracts in which a party is indemnified, or excused from being held liable, for damages resulting from that party’s negligence.” As of March 2024, House Bill 1164 does not appear to have advanced beyond a “referral to Commerce”.

## CHOICE OF LAW

“[T]he first step in a choice of law analysis under Pennsylvania law is to determine whether a conflict exists between the laws of the competing states. If no conflict exists, further analysis is unnecessary. If a conflict is found, it must be determined which state has the greater interest in the application of its law. Weighing these interests requires a further determination as to which state had the most significant contacts or relationships with the insurance contract.” *Budtel Assocs., LP v. Cont’l Cas. Co.*, 915 A.2d 640, 643 (Pa. Super. 2006). The Third Circuit Court of Appeals has concluded that “Pennsylvania applies the more flexible ‘interest/contacts’ methodology to contract choice of law questions.” *Hammersmith v. TIG Insurance Co.*, 480 F.3d 220 (3d Cir. 2007).

In *Hammersmith*, the issue was late notice and there was a conflict between the laws of Pennsylvania and New York as to the requirement of prejudice. The Court analyzed each state’s contacts, bearing in mind that the court was concerned with the contract of insurance and not the underlying tort. Noting that when the policy covers a group of risks that are scattered throughout two or more states, the location of the insured risk has less significance to the choice of law determination. Because notice was the issue in *Hammersmith*, the place of contracting, negotiation, and performance were the most relevant contacts. Other contacts that are relevant depending on the issue are the location of the subject matter of the contract and the place of incorporation and place of business of the parties.

In a duty to defend context, the Third Circuit Court of Appeals noted that while the Pennsylvania Supreme Court had not spoken on the issue, the Superior Court consistently emphasized that Pennsylvania’s choice of law rules were concerned with examining the states’ contacts with the contract of insurance, not the tort involved in the underlying suit. In *Specialty Surfaces International, Inc. v. Continental Cas. Co.*, 609 F.3d 223 (3d Cir. 2010), the Third Circuit accorded little weight to the place where the lawsuit was filed finding that contact was not significantly related to the coverage question at issue, which involved the “occurrence” definition and claims of poor workmanship.

## DUTIES IMPOSED BY STATE LAW

### Duty to Defend

#### 1. Standard for Determining Duty to Defend

The insurer agrees to defend the insured against any suits arising under the policy ‘even if such suit is groundless, false, or fraudulent.’ A refusal without good cause to defend breaches this obligation and gives rise to a cause of action regardless of the good faith of the insurer. Based on the usual contract rule for determining damages, the recovery for breach of the covenant to defend will ordinarily be the cost of hiring substitute counsel and other costs of the defense. This recovery may be in addition to any other obtained against the insurer. *Gedeon v. State Farm Mutual Automobile Ins. Co.*, 188 A. 2d 320, 321-22 (Pa. 1963).

An insurer’s duty to defend “is a distinct obligation” that is “different from and broader than the duty to indemnify.” *Sikirica v. Nationwide Ins. Co.*, 416 F.3d 214, 225 (3d Cir.2005) (citations omitted). It is well settled under Pennsylvania law that the allegations in the complaint in the underlying action alone fix the insurer’s duty to defend. *United Services Auto. Assn. v. Elitzky*, 517 A. 2d 982, 985 (Pa. Super. 1986). If the allegations of the complaint, taken as true and construed



liberally, state a claim to which the policy potentially applies, the insurer must defend, unless and until it can narrow the claim to a recovery that policy does not cover. *Cadwallader v. New Amsterdam Cas. Co.*, 152 A.2d 484, 488 (Pa. 1959). The particular cause of action that a complainant pleads is not determinative of whether coverage has been triggered. Instead, it is necessary to look at the factual allegations contained in the complaint. *Mutual Benefit Ins. Co. v. Haver*, 725 A.2d 743, 745 (Pa. 1999).

In *Kvaerner v. Commercial Union Ins. Co.*, 908 A. 2d 888 (Pa. 2006), the Pennsylvania Supreme Court held that it was error for the Pennsylvania Superior Court to look beyond the allegations of the underlying complaint to determine that the insurer owed a duty to defend its insured. In *Kvaerner*, the Pennsylvania Supreme Court reviewed the allegations of the underlying complaint and the language of the policy and reversed the Pennsylvania Superior Court. The Pennsylvania Supreme Court held that there was no duty to defend or indemnify because faulty workmanship does not constitute an “accident” as required to set forth an “occurrence” under the policy.

In *American and Foreign Ins. Co. v. Jerry’s Sport Center, Inc.*, 2 A.3d 526 (Pa. 2010), the Pennsylvania Supreme Court held that the insurer was not entitled to a reimbursement of defense costs after a finding of no duty to defend noting that the policy did not contain a provision providing for reimbursement of defense costs under any circumstances.

## 2. Issues with Reserving Rights

It is generally recognized that a liability insurer will not be estopped to set up the defense that the insured's loss was not covered by the insurance policy, notwithstanding the insurer's participation in the defense of an action against the insured, if the insurer gives timely notice to the insured that it has not waived the benefit of its defense under the policy. However, a reservation of rights in this respect, to be effective, must be communicated to the insured. It must fairly inform the insured of the insurer's position and must be timely, although delay in giving notice will be excused where it is traceable to the insurer's lack of actual or constructive knowledge of the available defense. *Brugnoli v. United Nat. Ins. Co.*, 426 A.2d 164, 167 (Pa. Super. 1981) (quoting 14 G. Couch, *Cyclopedia of Insurance Law* § 51:83 (2d ed. 1965)).

A reservation of rights letter should be prompt and thorough. *Beckwith Machinery Co., v. Travelers Indem. Co.*, 638 F. Supp. 1179 (W.D. Pa. 1986). The failure of an insurer to reserve defenses may result in an estoppel to assert those defenses if the insured has relied on the insurer’s management of the defense to the detriment of the insured. *Petroski v. Wilson*, 92 A.2d 189 (Pa. 1952); *Lewis v. Fidelity & Cas. Co.*, 156 A. 73 (Pa. 1931). However, notice of a general reason will not prejudice reliance thereafter on a specific policy provision. *Nationwide Mut. Ins. Co. v. Nixon*, 682 A.2d 1310, 1314 (Pa. Super. 1996).

In *Erie Ins. Exch. v. Lobenthal*, 114 A.3d 832 (Pa. Super. 2015), Erie sent two reservation of rights letters addressed only to the named insureds, Mr. and Mrs. Lobenthal, the parents of the defendant driver, Michaela Lobenthal. Michaela was an adult and also an insured under the policy. Neither letter mentioned Michaela. Erie sent the second of the two reservation of rights letter to insurance defense counsel provided by Erie. The Pennsylvania Superior Court found the letters to be ineffective as to Michaela. The Court also found the Erie reservation of rights letter that was sent seven months after the complaint was filed and that raised a controlled substance exclusion was untimely.

In *Babcock & Wilcox Co. v. Am. Nuclear Insurers*, 131 A.3d 445 (Pa. 2015), the Pennsylvania Supreme Court was asked to decide the appropriate standard to apply in determining whether an insurer is liable under its insurance policy for a settlement made by its insured without securing the insurer's consent, when the insurer is defending the claim subject to a reservation of rights. The Court adopted a variation on a fair and reasonable standard limited to those cases where an insured accepts a settlement offer after an insurer breaches its duty by refusing the fair and reasonable settlement while maintaining its reservation of rights and, thus, subjects an insured to potential responsibility for the judgment in a case where the policy is ultimately deemed to cover the relevant claims. The Court observed that a determination of whether the settlement is fair and reasonable necessarily entails consideration of the terms of the settlement, the strength of the insured's defense against the asserted claims, and whether there is any evidence of fraud or collusion on the part of the insured. The Court further noted that if an insurer breaches its duty to settle while defending subject to a reservation of rights and the insured accepts a reasonable settlement offer, the insured need only demonstrate that the insurer breached its duty by failing to consent to a settlement that is fair, reasonable, and non-collusive, rather than demonstrating bad faith by the insurer, as the damages sought are subject to the policy limits to which the insurer originally contracted.

In *Selective Way Ins. Co. v. MAK Services, Inc.*, 232 A.3d 762 (Pa. Super. 2020), the Pennsylvania Superior Court found an insurer's reservation of rights letter and investigation deficient. Selective Way had advised its insured that the claim was "potentially covered" under the policy and that defense counsel was being appointed. The insured was free to retain its own counsel, but simultaneously instructed not to discuss the case with anyone other than Selective or the appointed attorney. Selective Way generally reserved all its rights under "applicable law, insurance regulations and policy provisions," including the right to deny coverage. However, the letter failed to specifically identify any emergent coverage issues.

Although Pennsylvania law does not require an insurer to list every potential defense to coverage in reserving its rights, the Superior Court held that *some* level of specificity is necessary. This position was supported by the insurer's duty to conduct an appropriately thorough investigation to preserve defenses to coverage, and the ability to send multiple reservation of rights letters during the evolution of a case. The Selective Way letter was deficient because the snow and ice removal exclusion was evident on the face of the policy, and Selective Way admitted to having knowledge of the exclusion from the outset. Despite such knowledge, Selective Way waited 18 months to raise the policy exclusion and provided no further intervening notice to the insured that it would need to provide its own defense. Accordingly, the Superior Court found that Selective Way was estopped from asserting the exclusion based on the prejudice to the insured caused by the delay in failing to "clearly communicate" the extent of the rights being reserved.

## State Privacy Laws; Insurance Regulatory Issues; Arbitration/Mediation

### 1. Criminal Sanctions

The Pennsylvania Administrative Code, Title 31 Insurance at Chapter 146A. Privacy of Consumer Financial Information, 31 Pa. Code §§ 146a.1 to 146a.44, and at Chapter 146B Privacy of Consumer



Health Information, 31 Pa. Code §§ 146b.1 to 146b.24 provides extensive regulations governing the treatment of nonpublic financial and health information by insurers. Chapter C sets forth standards for developing and implementing safeguards to protect private information.

Violations are deemed to be an unfair method of competition and an unfair or deceptive act or practice and subject to any applicable penalties or remedies contained in the Unfair Insurance Practices Act (40 P. S. §§ 1171.1--1171.15). See e.g. 146a.43. Violation.

Pursuant to 40 P.S. § 1171.9. Administrative penalty:

Upon a determination by hearing that this act has been violated, the Commissioner may issue an order requiring the person to cease and desist from engaging in such violation or, if such violation is a method of competition, act or practice defined in section 5 of this act,<sup>1</sup> the Commissioner may suspend or revoke the person's license.

In addition, the Commissioner is authorized to file an action seeking an injunction or to impose civil penalties. 40 P.S. §§ 1171.10, 1171.11.

### 2. The Standards for Compensatory and Punitive Damages

The Pennsylvania Supreme Court has held that the system of sanctions established under the UIPA need not be supplemented by a judicially created cause of action to deter bad faith conduct. *D'Ambrosio v. Pennsylvania Nat'l Mut. Cas. Ins. Co.*, 431 A.2d 966 (Pa. 1981).

The Pennsylvania Supreme Court has not addressed the question whether a violation of the UIPA is relevant to a claim of bad faith under Pennsylvania's bad faith statute, 42 Pa.C.S.A. § 8371. See, *Toy v. Metro. Life Ins. Co.*, 928 A.2d 186, n. 17 (Pa. 2007). The Pennsylvania Superior Court has stated that a trial court may consider the alleged conduct constituting violations of the UIPA and the Department of Insurance Regulations in determining whether the insurer acted in bad faith pursuant to 42 Pa.C.S.A. § 8371. *Romano v. Nationwide Mut. Fire Ins. Co.*, 646 A.2d 1228, 1233 (Pa. Super. 1984).

### 3. Insurance Regulations to Watch

### 4. State Arbitration and Mediation Procedures

Not applicable to administrative proceedings before the Pennsylvania Insurance Department.

### 5. State Administrative Entity Rule-Making Authority

The Pennsylvania Insurance Department

## EXTRACONTRACTUAL CLAIMS AGAINST INSURERS: ELEMENTS AND REMEDIES

## Bad Faith Claim Handling/Bad Faith Failure to Settle Within Limits

In 1990, the Pennsylvania Bad Faith Statute became effective. The statute provides as follows:

### Actions on insurance policies

In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:

- Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
- Award punitive damages against the insurer.
- Assess court costs and attorney fees against the insurer.

42 Pa. C.S.A. § 8371.

In *Rancosky v. Washington Nat'l Ins. Co.*, 170 A. 3d 364, 377 (Pa. 2017), the Pennsylvania Supreme Court set forth the standard to be applied in determining whether an insurer acted in bad faith pursuant to Pennsylvania's insurance bad faith statute, 42 Pa.C.S. §8371, as follows:

In summary, we hold that, to prevail in a bad faith insurance claim pursuant to *Section 8371*, a plaintiff must demonstrate, by clear and convincing evidence, (1) that the insurer did not have a reasonable basis for denying benefits under the policy and (2) that the insurer knew or recklessly disregarded its lack of a reasonable basis in denying the claim. We further hold that proof of the insurer's subjective motive of self-interest or ill-will, while perhaps probative of the second prong of the above test, is not a necessary prerequisite to succeeding in a bad faith claim. Rather, proof of the insurer's knowledge or reckless disregard for its lack of reasonable basis in denying the claim is sufficient for demonstrating bad faith under the second prong.

### 3. First Party

*Rancosky, supra*, involved a cancer policy issued by Conseco and a denial of benefits based on a discrepancy in the start date of Plaintiff Rancosky's disability and her waiver of premium status. Rancosky succeeded at a jury trial on her breach of contract claim. A non-jury trial resulted in a verdict in favor of Conseco on Rancosky's bad faith claim. On appeal, the Pennsylvania Superior Court made its own determination that Conseco lacked a reasonable basis for denying Rancosky's claim because Conseco failed to investigate the discrepancies in the start date of her disability. The Superior Court held that the second prong of the bad faith test, i.e. that the insurer knew or recklessly disregarded its lack of a reasonable basis in denying the claim, did not require proof of an insurer's motive of self-interest or ill-will. As stated above, the Pennsylvania Supreme Court agreed with the Superior Court that lack of such evidence is not fatal to a bad faith claim.

In *Toy v. Metropolitan Life Ins. Co.*, 928 A. 2d 186 (Pa. 2007), the Pennsylvania Supreme Court held that a bad faith claim within the meaning of § 8371 may not be premised on allegations that an insurer engaged in deceptive or unfair conduct in *soliciting* the insured to purchase an insurance policy.

In *Mohney v. Am. General Life Ins. Co.*, 116 A.3d 1123 (Pa. Super. 2015), the Pennsylvania Superior Court reversed a trial court's finding of no bad faith conduct by American General Life in

terminating Plaintiff Mohny's disability claim and remanded the case to the trial court. Among other issues, the Superior Court determined that U.S. Life's investigation did not provide any reasonable basis for its decision to terminate benefits.

#### 4. Third-Party

In the third party context, an insurer is subject to claims of bad faith claims handling in failing to settle within limits. The amount of recovery for breach of the duty to indemnify is usually determined by the terms of the policy. *Gedeon v. State Farm Mut. Automobile Ins. Co.*, 188 A. 2d 320, 321-22 (Pa. 1963). However, by asserting the right to handle all claims against the insured, including the right to make a binding settlement, the insurer assumes a fiduciary position towards the insured and becomes obligated to act in good faith and with due care in representing the interests of the insured. If the insurer is derelict in this duty, as where it negligently investigates the claim or unreasonably refuses an offer of settlement, it may be liable regardless of the limits of the policy. *Gideon*, supra. In determining whether to settle a liability claim, the insurer is not bound to submerge its own interest in order that the insured's interest may be made paramount. *Cowden v. Aetna Cas. & Sur. Co.*, 134 A. 2d 223, 228 (Pa. 1957).

In *The Birth Center v. St. Paul Companies, Inc.*, 787 A.2d 376 (Pa. 2001), the Pennsylvania Supreme Court held that where an insurer acts in bad faith by unreasonably refusing to settle a claim, the insurer is liable for the known and/or foreseeable compensatory damages of its insured that reasonably flow from the bad faith conduct. In that case, the insurer had paid the excess verdict, but was still liable to its insured for lost profits and damage to reputation resulting from the entry of the excess judgment.

Based on the Pennsylvania Supreme Court's decision in *The Birth Center*, an insurer is potentially exposed to liability for the amount of the excess verdict; to liability for punitive damages and attorney's fees under the bad faith statute, 42 Pa.C.S.A. §8371; and to liability for its insured's known or foreseeable compensatory damages for breach of contract as a result of its bad faith conduct.

There is no direct right of action by a third party claimant against the defendant's insurer. However, the third party claimant can proceed against the insurer by assignment from the defendant-insured of the defendant's rights against the insurer. *Gray v. Nationwide Mut. Ins. Co.*, 223 A.2d 8 (Pa. 1966). See also, *Johnson v. Beane*, 664 A. 2d 96, 98-99, n. 2-3 (Pa. 1995); *Brown v. Candelora*, 708 A.2d 104 (Pa. Super. 1998).

In *Allstate Prop. & Cas. Ins. Co. v. Wolfe*, 105 A.3d 1181 (Pa. 2014), the Pennsylvania Supreme Court concluded that the entitlement to assert damages under the Bad Faith Statute, 42 Pa. C.S. §8371, may be assigned by an insured to an injured plaintiff and judgment creditor. The question had been certified to the Pennsylvania Supreme Court by the Third Circuit Court of Appeals.

## Fraud

The elements of fraud are as follows:

- A representation;
- which is material to the transaction at hand;

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- made falsely, with knowledge of its falsity or recklessness as to whether it is true or false;
- with the intent of misleading another into relying on it;
- justifiable reliance on the misrepresentation; and,
- the resulting injury was proximately caused by the reliance.

*Bortz v. Noon*, 729 A. 2d 555, 560 (Pa. 1999)

"[T]he tort of intentional non-disclosure has the same elements as intentional misrepresentation except in the case of intentional non-disclosure the party intentionally conceals a material fact rather than making an affirmative misrepresentation.[citation omitted]." *Id.* However, mere silence is not sufficient to constitute fraud in the absence of a duty to speak. *Duquesne Light Co. v. Westinghouse Electric Corp.*, 66 F. 3d 604, 612 -13 (3d Cir. 1995).

### Intentional or Negligent Infliction of Emotional Distress

- Intentional Infliction of Emotional Distress

The Pennsylvania Supreme Court has stated that "[t]he possibility cannot be ruled out that emotional distress damages may be recoverable on a contract where, for example, the breach is of such a kind that serious emotional disturbance was a particularly likely result. *D'Ambrosio v. Pa. Nat. Mut. Ins.*, 431 A. 2d 966 (Pa. 1981).

The Pennsylvania Supreme Court has not yet decided whether a cause of action for intentional infliction of emotional distress is cognizable under Pennsylvania law. *See Hoy v. Angelone*, 720 A. 2d 745 (Pa. 1998); *Kazatsky v. King David Memorial Park, Inc.*, 527 A. 2d 988 (Pa. 1987). However, federal courts applying Pennsylvania law have predicted that the Pennsylvania Supreme Court will recognize this tort. *Pavlik v. Keen (World Marketing) Limited*, 135 F. 3d 876 (3d Cir. 1998).

While not expressly recognizing the tort, the Pennsylvania Supreme Court has identified the minimum requirements if the tort were to be accepted in Pennsylvania. Defendant's conduct must be extreme and outrageous to state a cause of action for intentional infliction of emotional distress. For guidance, the Pennsylvania courts have looked to the Restatement (Second) of Torts § 46.

The Restatement (second) of Torts § 46 provides:

#### Outrageous Conduct Causing Severe Emotional Distress

(1) One who by extreme and outrageous conduct intentionally or recklessly causes severe emotional distress to another is subject to liability for such emotional distress, and if bodily harm to the other results from it, for such bodily harm.

The Restatement states that extreme and outrageous conduct goes beyond all possible bounds of decency.

A plaintiff must substantiate that he actually suffered the claimed distress with expert medical confirmation and objective proof. *Hunger v. Grand Central Sanitation*, 670 A. 2d 173 (Pa. Super. 1996).

- Negligent Infliction of Emotional Distress

The Pennsylvania Superior Court has recognized four factual scenarios which may support a claim for negligent

infliction of emotional distress:

"(1) situations where the defendant had a contractual or fiduciary duty toward the plaintiff; (2) the plaintiff was subjected to a physical impact; (3) the plaintiff was in a zone of danger, thereby reasonably experiencing a fear of impending physical injury; or (4) the plaintiff observed a tortious injury to a close relative."

*Weiley v. Albert Einstein Medical Center*, 51 A.3d 202, 217 (Pa. Super. 2012) (quoting *Toney v. Chester County Hosp.*, 961 A.2d 192, 198 (Pa. Super. 2008), *aff'd by an equally divided court*, 36 A.3d 83 (Pa. 2011)).

The first scenario was presented in Toney, which involved a claim by the mother of a severely deformed baby who claimed that the defendants' negligent misinterpretation of an ultrasound prevented her from preparing herself for the shock of witnessing her son's birth with such substantial physical deformities. In the decision in support of affirmance in the Pennsylvania Supreme Court, the reach of this cause of action was explained to be limited to:

preexisting relationships involving duties that obviously and objectively hold the potential of deep emotional harm in the event of breach. . . . [T]he special relationships must encompass an implied duty to care for the plaintiff's emotional well-being. . . . Compensable emotional harm has been described as likely to be experienced as a visceral and devastating assault on the self such that it resembles physical agony in its brutality. . . . [R]elationships involving life and death fall within this category. . . . It is impossible . . . to create an exhaustive list of qualifying relationships in this opinion. . . . Nonetheless, we would hold that some relationships, including some doctor-patient relationships, will involve an implied duty to care for the plaintiff's emotional well-being that, if breached, has the potential to cause emotional distress resulting in physical harm.

*Toney*, 36 A.3d at 95 (internal quotations and citation omitted).

In the insurance context, the Pennsylvania Supreme Court has stated that "[t]he possibility cannot be ruled out that emotional distress damages may be recoverable on a contract where, for example, the breach is of such a kind that serious emotional disturbance was a particularly likely result. *D'Ambrosio v. Pa. Nat. Mut. Ins.*, 431 A. 2d 966 (Pa. 1981).

The Pennsylvania Supreme Court has generally denied recovery for emotional distress, unless accompanied by physical impact or physical injury, noting that the Second Restatement also follows this approach. See RESTATEMENT (SECOND) OF TORTS § 436A (1965) ("If the actor's conduct is negligent as creating an unreasonable risk of causing either bodily harm or emotional disturbance to another, and it results in such emotional disturbance alone, without bodily harm or other compensable damage, the actor is not liable for such emotional disturbance."); RESTATEMENT (SECOND) OF TORTS § 456 cmt. b (1965) ("Where the tortious conduct does not result in bodily harm, there can ordinarily be no recovery for mere emotional disturbance which has no physical consequences."). Physical impact and physical injury are not synonymous terms, however. [citation omitted]. *Schmidt v. Boardman Co.*, 11 A.3d 924, 948 (Pa. 2011).

### State Consumer Protection Laws, Rules and Regulations

The Unfair Trade Practices and Consumer Protection Law (UTCPL) bars certain types of "unfair methods of competition" and "unfair or deceptive acts or practices." 73 P.S. § 201-3. Unlike the UIPA, the UTCPL explicitly creates a private cause of action in favor of consumers. 73 P.S. § 201-9.2. The provisions of the UTCPL most likely to be cited in a complaint against an insurance carrier include the following:

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- Causing likelihood of confusion or of misunderstanding as to the source, sponsorship, approval or certification of goods or services;
- Causing likelihood of confusion or of misunderstanding as to affiliation, connection or association with, or certification by, another;
- . . .
- Disparaging the goods, services or business of another by false or misleading representation of fact;
- Advertising goods or services with intent not to sell them as advertised;
- Making false or misleading statements of fact concerning the reasons for, existence of, or amounts of price reduction;
- . . .
- Knowingly misrepresenting that services, replacements or repairs are needed if they are not needed;
- . . .
- Engaging in any other fraudulent or deceptive conduct which creates a likelihood of confusion or of misunderstanding.

73 P.S. § 201-2(4) (emphasis added).

The law in Pennsylvania is clear that nonfeasance, such as an insurer's mere refusal to pay a claim, is insufficient to state a cause of action under the Unfair Trade Practices and Consumer Protection Law, 73 P.S. §201-1 *et seq.*, *Horowitz v. Kemper Life Assur. Co.*, 57 F. 3d 300 (3d Cir. 1995). Affirmative action on the part of the insurer, rather than inaction, must be alleged. *MacFarland v. U.S. Fidelity & Guaranty Co.*, 818 F. Supp. 108 (E.D. Pa. 1993).

The cause of action under the UTPCPL is limited to persons purchasing goods or services primarily for personal, family or household purposes. It is not available to commercial policyholders. *Trackers Raceway, Inc. v. Comstock Agency, Inc.*, 583 A. 2d 1193 (Pa. Super. 1990).

In *Grimes v. Enter. Leasing Co. of Phila., LLC*, 105 A.3d 1188 (Pa. 2014), the Pennsylvania Supreme Court held that the mere acquisition of counsel would not suffice to satisfy the "ascertainable loss" requirement.

In *Grimes*, the Pennsylvania Supreme Court had also granted review to consider whether a private plaintiff who alleges deceptive conduct under the UTPCPL's "catchall" provision need not plead or prove justifiable reliance. The Court did not address that question because the "ascertainable loss" issue was dispositive.

However, in *Toy v. Metropolitan Life Ins. Co.*, 928 A.2d 186 (Pa. 2007), the Court stated that justifiable reliance is an element of a Consumer Protection Law claim. See also, *Kern v. Lehigh Valley Hosp.*, 108 A.3d 1281 (Pa. Super. 2015) ("[O]ur Supreme Court has decided and reaffirmed that justifiable reliance is an element of all private claims under the UTPCPL.")

In *Schwartz v. Rockey*, 932 A. 2d 885 (Pa. 2007), an action by home purchasers against the sellers for fraudulent non-disclosure and/or concealment of water infiltration, the Pennsylvania Supreme Court held "as a matter of statutory construction, that the courts' discretion to [award] treble damages under the UTPCPL should not be closely constrained by the common-law requirements associated with the award of punitive damages". The effect of the Court's holding is that the standard for an award of punitive damages as described in *Feld v. Merriam*, 485 A.2d 742, 747-48 (Pa. 1984), i.e., that "punitive damages may be awarded for conduct that is outrageous, because



of the defendant's evil motive or his reckless indifference to the rights of others." (quoting Restatement (Second) of Torts §908(2) (1977)), does not apply to an award of treble damages under the UTPCPL. However, in affirming the decision of the Pennsylvania Superior Court, the Pennsylvania Supreme Court also cautioned that "courts of original jurisdiction should focus on the presence of intentional or reckless, wrongful conduct, as to which an award of treble damages would be consistent with, and in furtherance of, the remedial purposes of the UTPCPL".

In addition to a Consumer Protection Law claim, an insured may bring a fraud or misrepresentation claim if the circumstances support it. *Elliott v. State Farm Mut. Auto. Ins. Co.*, 786 F. Supp. 487, 491-92 (E.D. Pa. 1992); *Brownell v. State Farm Mutual Ins. Co.*, 757 F. Supp. 526, 531-32 (E.D. Pa. 1991). An insured also has a private cause of action against an insurer for "bad faith," pursuant to 42 Pa.C.S.A. § 8371.

## DISCOVERY ISSUES IN ACTIONS AGAINST INSURERS

### Discoverability of Claims Files Generally

There is "ample authority to support a ruling that the claims file or claims log should be disclosed in a bad faith action against the insurance carrier." *Marshall v. Nationwide Mut. Ins. Co.*, 1994 U.S. Dist. LEXIS 7834 (E.D. Pa. 1994); *see also Yohe v. Nationwide Mut. Life Ins. Co.*, 7 Pa.D.& C. 4<sup>th</sup> 300, 304-05 (York Co. 1990). Generally, the adjuster's notes and claims file must be produced in any case "where the conduct of the representative is, itself, the subject of the litigation." *Mueller v. Nationwide Mut. Ins. Co.*, 31 Pa.D&C.4<sup>th</sup> 23, 28 (Allegheny Co. 1996) (brackets omitted). This holds true for bad faith, insurance coverage, and declaratory judgment actions. Any relevant material, "not privileged or protected by rule 4003.3 or any other rule, . . . is discoverable." *Yohe*, 7 Pa.D.&C.4<sup>th</sup> at 305.

"The scope of [the bad faith statute] has been extended to the investigatory practices of an insurer during litigation initiated by an insured to obtain the proceeds of his or her insurance policy." *McAndrew v. Donegal Mut. Ins. Co.*, 56 Pa.D.&C.4<sup>th</sup> 1, 11 (Lackawanna Co. 2002) (citation omitted). Consequently, in a bad faith action, the insured may be entitled to discovery of adjuster notes or claims diary entries occurring after the denial of a claim and/or initiation of litigation. *Id.*; *see also Hollock v. Erie Ins. Exchange*, 842 A.2d 409, 414-16 (Pa. Super. 2004) (discussing the lower court's finding of bad faith based on an insurer's post-litigation efforts to conceal, hide, and cover-up the conduct of employees).

Typically, there are two objections raised to the production of an insurer's claims diary and related materials; they are the "work product doctrine" and the "attorney-client privilege." *Reusswig v. Erie Ins.*, 49 Pa.D&C.4<sup>th</sup> 338, 348 (Monroe Cty. 2000). The Pennsylvania Rule of Civil Procedure concerning the protection of work product (meaning documents prepared in anticipation of litigation) is significantly weaker than its federal counterpart. Moreover, Pennsylvania courts have held that the work product doctrine applies "only to the litigation of the claims for which the impressions, conclusions, and opinions were made," and not to any subsequent litigation. *Mueller*, 31 Pa.D&C.4<sup>th</sup> 23, 27.

By its own terms, Pennsylvania Rule of Civil Procedure 4003.3 only protects an insurance adjuster's "mental impressions, conclusions or opinions respecting the value or merit of a claim or defense or respecting strategy or tactics." Federal Rule of Civil Procedure 26(b)(3), on the other hand, provides more protection, by applying to a broader spectrum of materials. *See Garvey v. National Grange Mut. Ins. Co.*, 167 F.R.D. 391, 393-94 (E.D. Pa. 1996). However, the insurer must still show that the adjuster notes or claims diary entries were made in anticipation of litigation, and even in that circumstance, the insured is frequently able to make a showing of "substantial need" in order to overcome the protection of the work product doctrine.

The attorney-client privilege is protected in both state and federal court. The insurer, however, must be mindful that by placing the attorney's advice at issue, the insurer thereby waives the protection of the privilege. "The advice of counsel is placed in issue where the [insurer] asserts a claim or defense, and attempts to prove that claim or defense by disclosing or describing the attorney client communication." *Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 32 F.3d 851, 863 (3<sup>rd</sup> Cir. 1994); *McAndrew*, 56 Pa.D.&C.4<sup>th</sup> at 12-15; *Fidelity and Deposit Co. of Maryland v. McCulloch*, 168 F.R.D. 516, 520 (E.D.Pa. 1996).

The Pennsylvania Supreme Court held that in Pennsylvania, the attorney-client privilege operates in a two-way fashion to protect confidential client-to-attorney or attorney-to-client communications made for the purpose of obtaining or providing professional legal advice. *Gillard v. AIG Ins. Co.*, 15 A.3d 44 (Pa. 2011).

In *Rhodes v. USAA Cas. Ins. Co.*, 21 A.3d 1253 (Pa. Super. 2011), the Pennsylvania Superior Court reversed an order compelling the production of the underinsured motorist claim file of *counsel for the plaintiff-insured* in a bad faith action involving an underinsured motorist claim, stating that it is the state of mind of the insurer that is relevant in the bad faith action and not the state of mind of the insured. The court however noted that it was conceivable that in certain circumstances, a plaintiff's attorney's work product in the underlying claim could become relevant in a subsequent bad faith action, and in that situation, the court should conduct an in camera review of the attorney's file to weed out any protected material.

### Discoverability of Reserves

Discovery of reserves that the insurer had placed on the underlying claim has been found discoverable in a bad faith case. *North River Ins. Co. v. Greater New York Mut. Ins. Co.*, 872 F. Supp. 1411 (E.D. Pa. 1995); *Steward v. State Farm*, No. 99-5658 (E.D. Pa. Apr. 2000); *Consugar v. Nationwide Ins. Co. of America*, 2011 U.S. Dist. Lexis 61756 (M.D. Pa. 2011); *Shaffer v. State Farm Mut. Auto. Ins. Co.*, 2014 U.S. Dist. LEXIS 30436 (M.D. Pa. 2014).

However, in *Fidelity & Deposit Co. v. McCulloch*, 168 F.R.D. 516 (E.D. PA. 1996), the court refused to allow discovery of reserve information and distinguished *North River*, in which liability was undisputed and reserve information might provide insight into the company's mind set in refusing to settle the case, from the case before it, in which liability was disputed and the level of reserves would likely reveal no more than that the cost of defending the actions rose as time passed.

In *Kaufman v. Nationwide Mutual Ins. Co.*, 1997 U.S. Dist. Lexis 18530 (E. D. Pa. 1997), Nationwide had produced the amount of reserve it set for the specific underinsured motorist claim filed by plaintiff. The court denied plaintiff's request for discovery of reserve setting procedures, finding such discovery would not lead to the discovery of admissible evidence. A similar result was reached in *Cantor v. Equitable Life Assur. Soc. of U.S.*, 1998 U.S. Dist. Lexis 8435 (E.D. Pa. 1998).

In *Mirarchi v. Seneca Specialty Ins. Co.*, 2011 U.S. Dist. Lexis 80871 (E.D. Pa. 2011), a bad faith action arising out of a coverage dispute between plaintiff and his property insurer, the court concluded that the insurer's reserve figures were not relevant. However, the court ordered the production of the unredacted documents for court review because the underlying facts that the insurer considered in arriving at a reserve figure could be relevant.

In *PECO Energy Co. v. Ins. Co. of N. Am.*, 852 A.2d 1230 (Pa. Super. 2004), which did not include a bad faith claim, the Pennsylvania Superior Court did not permit discovery of reserve information.

## Discoverability of Existence of Reinsurance and Communications with Reinsurers

The federal courts generally require disclosure of reinsurance agreements under Fed.R.Civ.P. 26(a)(1)(D), which dictates production of "any insurance agreement." This disclosure, however, has been limited to cases in which a money judgment is sought as opposed to purely declaratory relief. *Medmarc Cas. Ins. Co. v. Arrow Int'l, Inc.*, 2002 U.S. Dist. LEXIS 15082 (E.D.Pa. 2002). Pennsylvania state courts, on the other hand, require disclosure of all reinsurance materials if the plaintiff can show relevance, and the defendant fails to demonstrate commercial sensitivity and/or the presence of privileged materials or work product. *Koken v. One Beacon Ins. Co.*, 911 A.2d 1021, 1033 (Pa. Commw. Ct. 2006); *PECO Energy Co. v. Ins. Co. of North America*, 852 A.2d 1230, 1233-34 (Pa. Super. 2004).

Federal courts appear to require a stronger showing of relevance before ordering disclosure of reinsurance materials, other than the agreement itself. See *Medmarc Cas. Ins. Co.*, 2002 U.S. Dist. LEXIS 15082 (E.D.Pa. 2002). In *Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 139 F.R.D. 609 (E.D.Pa. 1991) (*the "Rhone I"*), the court denied discovery concerning reinsurance files, stating that there had been no allegation that the insurance policy was ambiguous, and discovery into extrinsic evidence would therefore not be permitted. *Id.* at 611-12. In *Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 1991 U.S. Dist. LEXIS 16336 (E.D.Pa. Nov. 7, 1991) (*the "Rhone II"*), the court permitted discovery of reinsurance materials, but only because the materials were directly related to the notice defense raised by many of the insurers.

## Attorney/Client Communications

Section 5928 of the Pennsylvania Judicial Code provides:

In a civil matter counsel shall not be competent or permitted to testify to confidential communications made to him by his client, nor shall the client be compelled to disclose the same, unless in either case this privilege is waived upon the trial by the client.

42 Pa. C.S. §5928.

"[W]hen the client is a corporation, the privilege extends to communications between its attorney and agents or employees authorized to act on the corporation's behalf." *Pennsylvania State University v. W.C.A.B. (Sox)*, 83 A.3d 1081, 1092 (Pa. Cmwlth. Ct. 2013) (quoting *In re Condemnation by City of Philadelphia in 16.2626 Acre Area*, 981 A.2d 391, 396 (Pa. Cmwlth. Ct. 2009)); *Red Vision Sys. v. Nat'l Real Estate Info. Servs., L.P.*, 108 A.3d 54 (Pa. Super. 2015).

In order to invoke the privilege properly and shift the burden to the party seeking disclosure to prove waiver or an exception, the following elements must be established:

- The asserted holder of the privilege is or sought to become a client.
- The person to whom the communication was made is a member of the bar of a court, or his subordinate.
- The communication relates to a fact of which the attorney was informed by his client, without the presence of strangers, for the purpose of securing either an opinion of law, legal services or assistance in a legal matter, and not for the purpose of committing a crime or tort.
- The privilege has been claimed and is not waived by the client.

Red Visions Systems, *supra*.

In *Gillard v. AIG Ins. Co.*, 15 A.3d 44 (Pa. 2011), the Pennsylvania Supreme Court held that, in Pennsylvania, the attorney-client privilege operates in a two-way fashion to protect confidential client-to-attorney or attorney-to-client communications made for the purpose of obtaining or providing professional legal advice.

The Court in *Gillard* distinguished the attorney-client privilege from the work-product privilege stating:

[O]ur holding does not obviate the work product privilege. Such privilege, unlike the attorney-client privilege, does not necessarily involve communications with a client. See *Pa.R.Civ.P. No. 4003.3* (exempting from discovery "disclosure of the mental impressions of a party's attorney or his or her conclusions, opinions, memoranda, notes or summaries, legal research or legal theories"). ...

Thus, while the two privileges overlap, they are not coterminous.

*Gillard v. AIG Ins. Co.*, 15 A.3d 44, n. 16 (Pa. 2011).

In a bad faith action, if the insurer asserts the "advice of counsel" defense, the insurer waives the attorney-client privilege. See *Rhone-Poulenc Rorer, Inc. v. Home Indemn. Co.*, 32 F.3d 851 (3d Cir. 1994); *Robertson v. Allstate Ins. Co.*, 1999 U.S. Dist. Lexis 2991 (E.D. PA 1999); *Mueller v. Nationwide Mut. Cas. Co.*, 31 Pa. D. & C.4th 23, 28 (Com. Pl. 1996).

In the Pennsylvania Superior Court decision in *The Birth Center v. The St. Paul Companies, Inc.*, 727 A.2d 1144 (Pa. Super. 1999) *aff'd on other grounds*, 787 A.2d 376 (Pa. 2001), the court found that St. Paul's argument that its payment of the excess verdict was conclusive evidence of its good faith put its state of mind directly in issue. Therefore, St. Paul waived the right to challenge discovery of disputed materials withheld on grounds of privilege.

## DEFENSES IN ACTIONS AGAINST INSURERS

### Misrepresentations/Omissions: During Underwriting or During Claim

In *Rohm and Haas Co. v. Continental Cas. Co.*, 781 A.2d 1172, 1179 (Pa. 2001), the Pennsylvania Supreme Court addressed the issue of fraud in the insurance context:

When an insured secures an insurance policy by means of fraudulent misrepresentations, the insurer may avoid that policy. *New York Life Ins. Co. v. Brandwene et ux.*, 172 A. 669 (Pa. 1934). See also *Smith and Judge, supra*. The burden of proving fraud must be established by clear and convincing evidence and rests with the party alleging it. *Id.* The clear and convincing standard requires evidence that is "so clear, direct, weighty, and convincing as to enable the jury to come to a clear conviction, without hesitancy, of the truth of the precise facts of the issue." *Lessner v. Robinson*, 592 A.2d 678, 681 (Pa. 1991). This court has previously observed that fraud "is never proclaimed from the housetops nor is it done otherwise than surreptitiously with every effort usually made to conceal the truth of what is being done. So fraud can rarely if ever be shown by direct proof. It must necessarily be largely inferred from the surrounding circumstances." *Shechter v. Shechter*, 76 A.2d 753, 755 (Pa. 1950).

In an insurance fraud case, the insurer must prove that the fraudulent misrepresentations were material to the risk assumed by the insurer. *Evans v. Penn Mutual Life Ins. Co. of Philadelphia*, 186 A. 133 (Pa. 1936). When knowledge or ignorance of certain information would influence the decision of an insurer in the issuance of a

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policy, assessing the nature of the risk, or setting premium rates, that information is deemed material to the risk assumed by the insurer. *A.G. Allebach, Inc. v. Hurley*, 540 A.2d 289 (Pa. Super. 1988). Furthermore, "fraud consists of anything calculated to deceive, whether by single act or combination, or by suppression of truth, or suggestion of what is false, whether it be by direct falsehood or by innuendo, by speech or silence, word of mouth or look or gesture." *Moser v. DeSetta*, 589 A.2d 679, 682 (Pa. 1991). That is, there must be a deliberate intent to deceive. *Evans, supra*. Finally, "the concealment of a material fact can amount to a culpable misrepresentation no less than does an intentional false statement." *Moser, supra* 589 A.2d at 682

Pursuant to Pennsylvania case law, an automobile insurance policy cannot be rescinded based on misrepresentation so as to void coverage for an innocent injured third party, except within 60 days of the policy's inception. *Klopp v. Keystone Insurance Companies*, 595 A.2d 1 (Pa. 1991). After the 60-day period, the policy may only be canceled, not rescinded. However, an insurer may rescind a policy of auto insurance as to the actual perpetrator of the fraud, where the fraud could not reasonably have been discovered within the 60 day period immediately following issuance of the policy; limited to those circumstances where the undiscovered fraud was of such a nature that it is clear that an insurer would never have accepted the risk inherent in issuing the policy. *Erie Insurance Exchange v. Lake*, 671 A.2d 681 (Pa. 1996).

In *AJT Props. v. Lexington Ins. Co.*, 26 Pa. D. & C.5th 302 (Lacka. Cty. 2012), the court noted that no state or federal court in Pennsylvania had recognized, or even analyzed, the validity of a "post-claim underwriting" theory in the context of a property damage claim. In *AJT Props.*, the court found that even assuming arguendo that such a doctrine were cognizable in Pennsylvania, it was inapplicable in that case because in those jurisdictions that have recognized the theory, have applied it only to situations where an insurer fails to perform any actual underwriting until after a claim has been made. In *AJT Props.*, the insurer had an underwriting inspection of the property completed almost three months prior to the flood and AJT's resultant claim.

### Failure to Comply with Conditions

An insurer must show actual prejudice in order to enforce a late notice provision as a condition to liability coverage. *Brakeman v. Potomac Ins. Co.*, 371 A.2d 193 (Pa. 1977). However, in the "claims-made" context, if an insured has clearly breached the notice requirement, an insurer need not show prejudice to deny coverage. *Ace Am. Ins. Co. v. Underwriters at Lloyds & Cos.*, 939 A.2d 935 (Pa. Super. 2007).

A cooperation clause is enforceable to avoid coverage only where an insurer can establish prejudice as a result of the failure to cooperate. *Forest City Grant Liberty Assocs. V. Genro II, Inc.*, 652 A.2d 948, 951 (Pa. Super. 1995).

### Challenging Stipulated Judgments: Consent and/or No-Action Clause

In an action against an insurer to recover an amount agreed upon by the insured and claimant to resolve a third party claim, the insured or claimant proceeding by assignment has the burden of justifying the settlement including the reasonableness of the amount. The burden of proof is satisfied by offering evidence to establish the case against the indemnitee. See *Martinique Shoes, Inc. v. New York Progressive Wood Heel Co.*, 217 A.2d 781 (Pa. Super. 1966).

### Preexisting Illness or Disease Clauses

- Statutes

The “Individual Accident and Sickness Insurance Minimum Standards Act”, 40 P.S. §776.1 includes a provision that limits the defense of pre-existing conditions:

40 P.S. § 776.6. Pre-existing conditions

(a) Notwithstanding the provisions of Section 618(A)(2) of the Insurance Company Law of 1921, if an insurer elects to use a simplified application form, with or without a question as to the applicant's health at the time of application, but without any questions concerning the insured's health history or medical treatment history, the policy must cover any loss occurring after twelve months from any preexisting condition and not specifically excluded from coverage by terms of the policy, and, except as so provided, the policy or contract shall not include wording that would permit a defense based upon preexisting conditions. Changes to policies or contracts required under this section, including changes to premium rates applicable thereto, shall be permitted by endorsement or rider."

Long-Term Care insurance is governed by 40 P.S. § 991.1101 *et seq.*, which includes the following:

§ 991.1107. Underwriting standards

The definition of the term 'pre-existing condition' under Section 1105(c) does not prohibit an insurer from using an application form designed to elicit the complete health history of the applicant and, on the basis of the answers on that application, for underwriting in accordance with that insurer's established underwriting standards. Unless otherwise provided in the policy or certificate, a pre-existing condition, regardless of whether it is disclosed on the application, need not be covered until the waiting period described in Section 1105(c)(2) expires. No long-term care insurance policy or certificate may exclude or use waivers or riders of any kind to exclude, limit or reduce coverage or benefits for a specifically named or describe pre-existing diseases or physical conditions beyond the waiting period described in Section 1105(c)(2)."

40 P.S. § 991.1105 titled “Disclosure and performance standards for long-term care insurance includes the following:

(c)(1) No long-term care insurance policy or certificate may use a definition of 'pre-existing condition' which is more restrictive than a definition of 'pre-existing condition' that means a condition for which medical advice or treatment was recommended by or received from a provider of health care services within six months preceding the effective date of coverage of an insured person."

(2) No long-term care insurance policy may exclude coverage for a loss or confinement which is the result of a preexisting condition unless such loss or confinement begins within six months following the effective date of coverage of an insured person."

- Case Law

In *Lawson v. Fortis Ins. Co.*, 301 F.3d 159, 162 (3d Cir. 2002), the issue was described as whether receiving treatment for the symptoms of an unsuspected or misdiagnosed condition prior to the effective date of coverage makes the condition a pre-existing one under the terms of the insurance policy. “In other words, we must determine whether it is possible to receive treatment “for” a condition without knowing what the condition is.” The minor child, Elena Lawson, was diagnosed with leukemia shortly after a



health insurance policy became effective. In finding that Elena's leukemia was not a pre-existing condition under the language of the policy, the Third Circuit stated:

Elena did not receive advice or treatment for leukemia before the effective date of coverage, so Plaintiffs' interpretation of the pre-existing condition language in the Fortis insurance policy should prevail. At a minimum, the contract language is ambiguous, and thus it should be construed against Fortis.

The Fortis insurance policy excludes coverage for a "Sickness, Injury, disease or physical condition for which medical advice or treatment was recommended by a Physician or received from a Physician within the five (5) year period preceding that Covered Person's Effective Date of Coverage." There is no doubt that the "sickness" here is leukemia. Therefore, the key word in the pre-existing condition exclusion for our purposes is "for." Elena received treatment "for" what were initially diagnosed as symptoms of a respiratory tract infection. Therefore, the treatment she received was not "for" leukemia, but "for" a respiratory tract infection.

The Pennsylvania statute governing long-term care insurance was enacted on December 15, 1992 and became effective on February 13, 1993. In *Yoder v. American Travelers Life Ins. Co.*, 814 A. 2d 229 (Pa. Super. 2002), the Pennsylvania Superior Court concluded that the legislature did not intend the provisions of the act to apply to policies issued prior to their adoption, but renewed thereafter.

*Real Estate Trust Co. of Philadelphia v. Metropolitan Life Ins. Co.*, 17 A.2d 416 (Pa. 1941) involved claims under four policies of life insurance where death resulted from mixed causes. The policies contained identical clauses providing for the payment of double indemnity in the event that "the death of the insured resulted in consequence of bodily injury effected solely through external, violent and accidental means . . . independently and exclusively of all other causes." Provision was also made that: "This indemnity shall not be payable if the death of the insured results directly or indirectly from disease or from bodily or mental infirmity." The court decided that the insured must prove that death was caused solely by "external" and "accidental means" and if a pre-existing condition may have been a contributing factor, the insured bore the burden of proof on that issue. *See also, Dunn v. Maryland Casualty Company*, 488 A.2d 313 (Pa. Super. 1985).

In *Schneider v. UNUM Life Ins. Co.*, 149 F. Supp. 2d 169 (E.D. PA. 2001), the court held that claims asserted by the insureds against the insurer based on violations of provisions of the Pennsylvania insurance code, 40 Pa. Cons. Stat. §§ 991.1105(b)(1), (c), 991.1107, and 991.1111(a), (d), and (e), and regulations promulgated by the Pennsylvania Insurance Commissioner, 31 Pa. Code § 89.94, 89.908 (d) were precluded from ERISA preemption by the Savings Clause, 29 U.S.C. § 1144 (b)(2)(A).

### Statutes of Limitations and Repose

Actions based on breach of contract are subject to a four-year statute of limitations. 42 Pa. C.S.A. §5525. Tort claims are subject to a two-year statute of limitations. 42 Pa. C.S.A. §5524. Fraud claims are subject to a two-year statute of limitations that runs from the date the claimant knew or should have known of the fraudulent act. *Bolus v. Beloff*, 950 F.2d 919 (3d Cir. 1991).

The Unfair Trade Practices and Consumer Protection Law is governed by a six-year statute of limitations. *Lesoon v. Metropolitan Life Ins. Co.*, 898 A.2d 620, 627 (Pa. Super. 2006).

In *Ash v. Continental Ins. Co.*, 932 A. 2d 877 (Pa. 2007), the Pennsylvania Supreme Court answered the question of

which statute of limitation was applicable to a claim under the bad faith statute, 42 Pa.C.S. § 8371. In *Ash*, the Court discussed the underpinnings of the Pennsylvania bad faith insurance statute. While noting that courts generally treat a breach of the duty of good faith and fair dealing as a breach of contract action, such decisions addressed the implied duty of good faith imposed on parties to a contract, rather than the duty of good faith imposed by § 8371. (The Supreme Court declined to engage in a discussion of whether such a duty is implied in every contract as the issue was not presently before the Court.)

The Pennsylvania Supreme Court acknowledged that the bad faith statute was enacted by the Legislature to deter bad faith and was preceded by the decision of the Pennsylvania Supreme Court in *D'Ambrosio v. Pennsylvania National Mut. Cas. Ins. Co.*, 431 A. 2d 966 (Pa. 1981) declining to recognize a cause of action in tort for the breach of an implied covenant of good faith and fair dealing. The Court concluded that the duty under § 8371 is one imposed as a matter of social policy rather than one imposed by mutual consensus, and “an action to recover damages for a breach of that duty derives primarily from the law of torts”. Therefore, the Court held that such an action is subject to the two-year statute of limitations under 42 Pa.C.S. § 5524.

## TRIGGER AND ALLOCATION ISSUES FOR LONG-TAIL CLAIMS

### Trigger of Coverage

In the asbestos bodily injury context, the Pennsylvania Supreme Court has adopted the continuous trigger of coverage: coverage is triggered under all policies on the risk from exposure to asbestos through manifestation. *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A. 2d 502, 507 (Pa. 1993).

In *Pa. Nat'l Mut. Cas. Ins. Co. v. St. John*, 106 A.3d 1 (Pa. 2014), a case involving contamination of a herd of cows, the Pennsylvania Supreme Court did not apply the continuous trigger of coverage, stating:

Our holding in *J.H. France* remains an exception to the general rule under Pennsylvania jurisprudence that the first manifestation rule governs a trigger of coverage analysis for policies containing standard CGL language. We therefore find *J.H. France* distinguishable and decline to apply the multiple trigger theory of liability to determine coverage under the Penn National policies for the damages sustained by Appellants' dairy herd.

### Allocation Among Insurers

In *J.H. France*, *supra*, the Pennsylvania Supreme Court held that all insurers whose policies were triggered were jointly and severally liable. The insured could select one policy to cover the loss up to its limits. The insurer whose policy was selected could pursue other insurers on the risk through the “other insurance” clause or principles of contribution. The insured is not responsible for a share of the liability for those periods when it was not insured.

With respect to the duty to defend, the Court held: “The defense of a claim is a right, as well as a duty, falling upon the insurer. In order to effectuate that right, we hold that the selection of the insurer or insurers to undertake a defense is to be made by the insurers. In the event that the insurers are unable to agree as to the conduct of the defense, then *J.H. France* shall be entitled to select an insurer.” *Id.*

## CONTRIBUTION ACTIONS

## Claim in Equity vs. Statutory

Under certain circumstances, Pennsylvania courts recognize a right to equitable contribution. In 2011, the Pennsylvania Legislature passed the Fair Share Act governing contribution in negligence actions.

### Elements

- Equitable Contribution

To recover on a claim of equitable contribution under Pennsylvania law, an insurer must show by a preponderance of the evidence that (1) it is one of several parties liable for a common debt or obligation; and (2) it discharged the debt for the benefit of the other parties. See *Great Northern Ins. Co. v. Greenwich Ins. Co.*, 372 Fed. App'x 253, 254 (3d Cir. 2010) (citing *In re Mellon's Estate*, 32 A.2d 749, 757 (Pa. 1943)).

In *Great Northern Ins. Co. v. Greenwich Ins. Co.*, the Third Circuit Court of Appeals found that Great Northern ("Chubb") had satisfied part one of the test by demonstrating that both Chubb and Greenwich insured the same party, Atlas Resources ("Resources"), and successfully showed that it and Greenwich were liable under their respective insurance policies for a common obligation to Resources.

- Statutory Contribution

Pennsylvania's "Fair Share Act" became effective June 28, 2011. Unless one of the statutory exceptions applies, a defendant will pay only its proportional share of liability and no more. Before the passage of the Fair Share Act, defendants in a negligence case who were found to be joint tortfeasors were jointly and severally liable for the entire verdict.

The Fair Share Act eliminates that risk with certain exceptions, including for a defendant found 60% or more at fault. The Act provides, in pertinent part:

42 Pa.C.S. § 7102

(a.1) Recovery against joint defendant; contribution.

(1) Where recovery is allowed against more than one person, including actions for strict liability, and where liability is attributed to more than one defendant, each defendant shall be liable for that proportion of the total dollar amount awarded as damages in the ratio of the amount of that defendant's liability to the amount of liability attributed to all defendants and other persons to whom liability is apportioned under subsection (a.2).

(2) Except as set forth in paragraph (3), a defendant's liability shall be several and not joint, and the court shall enter a separate and several judgment in favor of the plaintiff and against each defendant for the apportioned amount of that defendant's liability.

(3) A defendant's liability in any of the following actions shall be joint and several, and the court shall enter a joint and several judgment in favor of the plaintiff and against the defendant for the total dollar amount awarded as damages:

(i) Intentional misrepresentation.

(ii) An intentional tort.

- (iii) Where the defendant has been held liable for not less than 60% of the total liability apportioned to all parties.
- (iv) A release or threatened release of a hazardous substance under section 702 of the act of October 18, 1988 (P.L. 756, No. 108), known as the Hazardous Sites Cleanup Act.
- (v) A civil action in which a defendant has violated section 497 of the act of April 12, 1951 (P.L. 90, No. 21), known as the Liquor Code.

(4) Where a defendant has been held jointly and severally liable under this subsection and discharges by payment more than that defendant's proportionate share of the total liability, that defendant is entitled to recover contribution from defendants who have paid less than their proportionate share. Further, in any case, any defendant may recover from any other person all or a portion of the damages assessed that defendant pursuant to the terms of a contractual agreement.

(a.2) Apportionment of responsibility among certain nonparties and effect.

For purposes of apportioning liability only, the question of liability of any defendant or other person who has entered into a release with the plaintiff with respect to the action and who is not a party shall be transmitted to the trier of fact upon appropriate requests and proofs by any party. A person whose liability may be determined pursuant to this section does not include an employer to the extent that the employer is granted immunity from liability or suit pursuant to the act of June 2, 1915 (P.L. 736, No. 338), known as the Workers' Compensation Act. An attribution of responsibility to any person or entity as provided in this subsection shall not be admissible or relied upon in any other action or proceeding for any purpose. Nothing in this section shall affect the admissibility or nonadmissibility of evidence regarding releases, settlements, offers to compromise or compromises as set forth in the Pennsylvania Rules of Evidence. Nothing in this section shall affect the rules of joinder of parties as set forth in the Pennsylvania Rules of Civil Procedure.

The plain language of the Fair Share Act does not “specifically preempt” our common law holding that damages in strict liability actions must be apportioned equally among defendants. *Roverano v. John Crane, Inc.*, 226 A.3d 526, 539 (Pa. 2020) (finding liability must be apportioned on a per capita basis in strict liability asbestos cases).

## DUTY TO SETTLE

By virtue of the fact that the insurer controls the defense of the litigation, the insurer's conduct in handling the defense could give rise to a bad faith claim against the insurer. *Cowden v. Aetna Casualty Insurance Co.*, 134 A.2d 223, 227 (Pa. 1957). As the Court stated in *Cowden*: “[W]hen there is little possibility of a verdict or settlement within the limits of the policy, the decision to expose the insured to personal pecuniary loss must be based on a bona fide belief by the insurer, predicated upon all of the circumstances of the case, that it has a good possibility of winning the suit. While it is the insurer's right under the policy to make the decision as to whether a claim against the insured should be litigated or settled, it is not a right of the insurer to hazard the insured's financial well-being. Good faith requires that the chance of a finding of nonliability be real and substantial and that the decision to

litigate be made honestly. Good faith requires the chance of a finding of non-liability be real and substantial and that the decision to litigate be made honestly.”

By asserting in the policy the right to handle all claims against the insured, including the right to make a binding settlement, the insurer assumes a fiduciary position towards the insured and becomes obligated to act in good faith and with due care in representing the interests of the insured. If the insurer is derelict in this duty, as where it negligently investigates the claim or unreasonably refuses an offer of settlement, it may be liable regardless of the limits of the policy for the entire amount of the judgment secured against the insured. *Gedeon v. State Farm Mutual Automobile Ins. Co.*, 188 A. 2d 320, 321-22 (Pa. 1963).

As stated by the Pennsylvania Supreme Court, requiring insurers who act in bad faith to pay excess verdicts protects the insured from liability that, absent the insurer's bad faith conduct, the insured would not have incurred. Where an insurer acts in bad faith, by unreasonably refusing to settle a claim, it breaches its contractual duty to act in good faith and its fiduciary duty to its insured. Therefore, the insurer is liable for the known and/or foreseeable compensatory damages of its insured that reasonably flow from the insurer's bad faith conduct. *The Birth Center v. The St. Paul Companies*, 787 A.2d 376, 389 (Pa. 2001).

In *Wolfe v. Allstate Property & Cas. Ins. Co.*, 790 F. 3d 487 (3d Cir. 2015), the Third Circuit Court of Appeals addressed arguments raised by Allstate following a jury verdict of 0\$ in compensatory damages and \$50,000 in punitive damages against Allstate under the Pennsylvania Bad Faith Statute, 42 Pa. C.S. §8371. In an underlying liability suit brought by Wolfe against Allstate's insured, Karl Zierle, and defended by Allstate, a jury had returned a verdict against Zierle of \$15,000 in compensatory damages and \$50,000 in punitive damages. Allstate paid the compensatory damage award, but not the \$50,000 punitives award. The insured, Zierle, assigned his rights against Allstate to Wolfe in exchange for Wolfe's agreement not to pursue Zierle for the punitive damages.

In the trial of the bad faith action, the judge allowed Wolfe to present evidence of Allstate's highest offer to settle of \$1,200, the compensatory award of \$15,000 and the punitive damages claim and award of \$50,000. On appeal, on the issue of allowing evidence of the punitive damage award against Zierle, the Third Circuit predicted as follows:

We predict that the Pennsylvania Supreme Court would conclude that, in an action by an insured against his insurer for bad faith, the insured may not collect as compensatory damages the punitive damages awarded against it in the underlying lawsuit. Therefore, the punitive damages award was not relevant in the later suit and should not have been admitted.

The Third Circuit Court based its prediction on Pennsylvania's long-standing rule that a claim for punitive damages against a tortfeasor who is personally guilty of outrageous and wanted misconduct is excluded from insurance coverage as a matter of law. The Court also concluded that “[i]t follows from our reasoning that an insurer has no duty to consider the potential for the jury to return a verdict for punitive damages when it is negotiating a settlement of that case.” 790 F. 2d at 496.

The Court upheld the trial court's denial of summary judgment for Allstate on the breach of contract claim stating: “if a plaintiff is able to prove a breach of contract but can show no damages flowing from the breach, the plaintiff is nonetheless entitled to nominal damages.” *Id.* at 498. Finally, the Court found that the removal of the \$50,000 punitive damages award against Zierle as damages in the later suit had no bearing on the damages that could be awarded against Allstate under the statutory bad faith claim. The Court remanded the case to the trial court for a new trial on both the breach of contract and bad faith claims, at which no evidence of the \$50,000 punitive award would be allowed.

Pennsylvania legislative policy provides that insurers may not delay settling third-party claims just because the

insured objects. See 40 P.S. § 1171.5(a)(10)(xv). See *Caplan v. Fellheimer Eichen Braverman & Kaskey*, 68 F.3d 828 (3rd Cir. 1995). Section 1171.5 of the Unfair Insurance Practices Act specifically provides that an insured's objection cannot be the sole basis for refusing to pay a claim unless: (a) The insured claims sovereign, eleemosynary, diplomatic, military service, or other immunity from suit or liability with respect to such claim; (b) The insured is granted the right under the policy of insurance to consent to settlement of claims; or (c) The refusal of payment is based upon the insurer's independent evaluation of the insured's liability based upon all available information. See 40 P.S. § 1171.5(a)(10)(xv)(a)-(c). *Step-Plan Servs. v. Koresko*, 12 A.3d 401(Pa. Super. 2010).

## LH&D BENEFICIARY ISSUES

### Change of Beneficiary

"Designation of a beneficiary under Pennsylvania law is a matter of contract between the insurer and the insured. In order to change one's beneficiaries on an insurance policy, one must comply with the policy's terms." *John Hancock Mut. Life Ins. Co. v. Boyle*, 1986 U.S. Dist. LEXIS 20827 (E.D. Pa. 1986) (citing *Cody v. Met. Life Ins. Co.*, 5 A.2d 887 (Pa. 1939)). Pennsylvania, however, follows the equitable doctrine of "substantial compliance." *Cipriani v. Sun Life Ins. Co. of Am.*, 757 F.2d 78, 81 (3d Cir. 1985) (citing *Provident Mut. Life Ins. Co. v. Ehrlich*, 508 F.2d 129, 132-33 (3d Cir. 1975)). Under this doctrine, strict and literal compliance with the policy terms is not always necessary. *Ehrlich*, 508 F.2d at 132-33. Rather, "Pennsylvania courts will give effect to an insured's intention to change the beneficiary on an insurance policy where, even in the absence of strict compliance with the policy provisions, the insured has made every reasonable effort under the circumstances to comply with those provisions." *Cipriani*, 757 F.2d at 81. Put simply, "[t]he essential inquiry is whether . . . [it has been] . . . shown that the insured intended to execute a change to such an extent that effect should be given it." *Id.* (quoting *Prudential Ins. Co. of Am. v. Bannister*, 448 F. Supp. 807 (W.D. Pa. 1978)). *Diener v. Renfrew Ctrs., Inc.*, 2011 U.S. Dist. LEXIS 108352 (E.D. Pa. 2015)(Granting leave to amend complaint to provide details regarding efforts of deceased wife to effectuate a change of beneficiary from her estranged husband to her son and/or mother).

### Effect of Divorce on Beneficiary Designation

Section 6111.2 of the Pennsylvania Probate, Estates and Fiduciaries Code provides as follows:

§ 6111.2. Effect of divorce or pending divorce on designation of beneficiaries

- Applicability. --This section is applicable if an individual:
- is domiciled in this Commonwealth;
- designates the individual's spouse as beneficiary of the individual's life insurance policy, annuity contract, pension or profit-sharing plan or other contractual arrangement providing for payments to the spouse; and
- either:
- at the time of the individual's death is divorced from the spouse; or
- (ii) dies during the course of divorce proceedings, no decree of divorce has been entered pursuant to 23 Pa.C.S. § 3323 (relating to decree of court) and grounds have been established as provided in 23 Pa.C.S. § 3323(g).
- General rule. --Any designation described in subsection (a)(2) in favor of the individual's spouse or former



spouse that was revocable by the individual at the individual's death shall become ineffective for all purposes and shall be construed as if the spouse or former spouse had predeceased the individual, unless it appears the designation was intended to survive the divorce based on:

- the wording of the designation;
- a court order;
- a written contract between the individual and the spouse or former spouse; or
- a designation of a former spouse as a beneficiary after the
- divorce decree has been issued.
- Liability.
- Unless restrained by court order, no insurance company, pension or profit-sharing plan trustee or other obligor shall be liable for making payments to a spouse or former spouse which would have been proper in the absence of this section.
- Any spouse or former spouse to whom payment is made shall be answerable to anyone prejudiced by the payment.

20 Pa.C.S. § 6111.2

ERISA preempts Section 6111.2 of the Probate Code. *In re Estate of Sauers*, 613 Pa. 186, 32 A.3d 1241 (2011).

### The Slayer's Act

Pennsylvania's Slayer's Act provides as follows:

§ 8802. Slayer not to acquire property as result of slaying.

No slayer shall in any way acquire any property or receive any benefit as the result of the death of the decedent, but such property shall pass as provided in the sections following.

20 Pa.C.S. § 8802 (2012).

In *Burkland v. Burkland*, 2013 U.S. Dist. Lexis 11327 (E.D. Pa. 2013), involving an employer life insurance and accidental death plan, the court noted that it was unnecessary to determine whether ERISA preempts Pennsylvania's Slayer's Act because the federal common law that would apply if ERISA preempted the Slayer's Act is essentially the same in a "slayer" situation, i.e. that no person should be permitted to profit from his own wrong..

## INTERPLEADER ACTIONS

### Availability of Fee Recovery

Attorney's fees are recoverable in a state court action by statute.

42 Pa.C.S. § 2503. Right of participants to receive counsel fees.

The following participants shall be entitled to a reasonable counsel fee as part of the taxable costs of the matter:

- A possessor of property claimed by two or more other persons, if the possessor interpleads the rival claimants, disclaims all interest in the property and disposes of the property as the court may direct.
- The prevailing party in an interpleader proceeding in connection with execution upon a judgment.

## Differences in State vs. Federal

### State Court Interpleader

- Rule Interpleader

Pennsylvania Rule of Civil Procedure 2302 is titled Interpleader by Defendants and provides:

At any time during the pendency of an action, the court, of its own motion or upon petition of a defendant, may interplead the plaintiff and one or more claimants not parties of record. More than one claimant may be interpleaded.

Rule Interpleader involves a pending lawsuit in which a defendant may interplead claimants who are not parties to the action. Interpleader is unavailable as a remedy with respect to a claimant who is already a party to the action. Rule 2303 sets forth what must be plead in a Petition for Interpleader.

Rule 2303. Allegations Required in Petition. Stay of Proceedings

- The petition for interpleader shall allege
  - that a claimant not a party of record has made or is expected to make a demand upon the defendant as a result of which the defendant is or may be exposed to double or multiple liability to the plaintiff and to such claimant as to all or any part of the claim asserted by the plaintiff.
  - that the petition is filed in good faith and not in collusion with the plaintiff or any claimant.
  - the interest, if any, which the defendant claims in the money or property in controversy and whether the defendant is able (or if not, the reasons therefor) to pay or deliver that part of the money or property as to which he or she claims no interest into court or to such person as the court may direct.
  - whether the defendant has admitted the claim of, or subjected himself or herself to independent liability to, the plaintiff or any claimant in respect to the subject matter of the action.
- The petition shall be subscribed and verified.
- The filing of the petition shall stay all proceedings in the action until the court has disposed of the petition.

When an answer is filed to the Petition for Interpleader challenging the factual averments of the petition, an issue of fact is raised requiring the petitioner either to take depositions or to order the matter for disposition without depositions. *University City Savings and Loan Ass'n v. Girard Life Ins. Co. of America*, 257 A. 2d 92 (Pa. Super. 1969).

- Civil Action Interpleader

If there is no pending action against a person or entity seeking to undertake interpleader, a civil action interpleader may be commenced by that person or entity. *See, Harleysville Ins. Co. v. Lacontora*, 34 Phila. 257 (1997)(Interpleader action is the proper method for the resolution of competing claims to disbursement of insurance proceeds resulting from a fire in a building).

- Jury Trial

In *Slavin v. Slavin*, 84 A.2d 313 (Pa. 1951), an interpleader action which concerned the ownership of a sum of money deposited in court by the District Attorney of Allegheny County, the court granted an interpleader and brought a party on the record as interpleaded claimant and ordered the District Attorney to pay into court the sum of \$13,028.00. The dispute between the claimants was submitted to a jury.

### Federal Court Interpleader

- Rule Interpleader

Federal Rule of Civil Procedure 22 addresses interpleader by a plaintiff and by a defendant, stating:

#### Rule 22. Interpleader

- Grounds.
  - By a Plaintiff. Persons with claims that may expose a plaintiff to double or multiple liability may be joined as defendants and required to interplead. Joinder for interpleader is proper even though:
    - the claims of the several claimants, or the titles on which their claims depend, lack a common origin or are adverse and independent rather than identical; or
    - the plaintiff denies liability in whole or in part to
    - any or all of the claimants.
  - By a Defendant. A defendant exposed to similar liability may seek interpleader through a crossclaim or counterclaim.

Diversity of citizenship between Plaintiff and Defendants and amount in controversy must be satisfied in Rule Interpleader.

In *Allstate Life Ins. Co. v. McBrearty*, 2013 U.S. Dist. LEXIS 73737 (M.D. Pa. 2013), the court set forth general principles of interpleader:

"The purpose of the interpleader device is to allow 'a party who fears being exposed to the vexation of defending multiple claims to a limited fund . . . that is under his control a procedure to settle the controversy and satisfy his obligation in a single proceeding.'" *Prudential Ins. Co. of America v. Hovis*, 553 F.3d 258, 262 (3d Cir. 2009) (quoting 7 Charles Allen Wright & Arthur R. Miller, *Federal Practice & Procedure* § 1704 (3d ed. 2001)).

"[I]nterpleader allows a stakeholder who 'admits it is liable to one of the claimants, but fears the prospect of multiple liability[,] . . . to file suit, deposit the property with the court, and withdraw from the proceedings.'" *Id.* (quoting *Metro Life Ins. Co. v. Price*, 501 F.3d 271, 275 (3d Cir. 2007)). "The typical interpleader action proceeds in two distinct stages." *Id.* First, the court determines whether the interpleader action is proper and whether to discharge the stakeholder from liability. *Id.* Next, the court determines the rights of the claimants. *Id.*

...

"It is true that, '[b]ecause interpleader is an equitable proceeding, it is subject to dismissal based on equitable doctrines.'" *Hovis*, 553 F.3d at 263 (quoting *U.S. Fire Ins. Co. v. Asbestospray, Inc.*, 182 F.3d 201, 208 (3d Cir. 1999)). "It is a general rule that a party seeking interpleader must be free from blame in causing the controversy, and where he stands as a wrongdoer with respect to the subject matter of the suit . . . , he cannot have relief by interpleader." *Farmers Irrigating Ditch & Reservoir Co. v. Kane*, 845 F.2d 229, 232 (10th Cir. 1988). This rule "is meant to prevent a tortfeasor, facing claims from multiple parties, from using the interpleader device to cap its liability." *Hovis*, 553 F.3d at 263 n.4.

- Statutory Interpleader

In statutory interpleader, the court has jurisdiction if the value is \$500 or more and two or more adverse claimants, of diverse citizenship claim or may claim to be entitled to the money or property. The statute provides as follows:

28 USCS § 1335

§ 1335. Interpleader

- The district courts shall have original jurisdiction of any civil action of interpleader or in the nature of interpleader filed by any person, firm, or corporation, association, or society having in his or its custody or possession money or property of the value of \$ 500 or more, or having issued a note, bond, certificate, policy of insurance, or other instrument of value or amount of \$ 500 or more, or providing for the delivery or payment or the loan of money or property of such amount or value, or being under any obligation written or unwritten to the amount of \$ 500 or more, if
  - Two or more adverse claimants, of diverse citizenship as defined in subsection (a) or (d) of section 1332 of this title [28 USCS § 1332], are claiming or may claim to be entitled to such money or property, or to any one or more of the benefits arising by virtue of any note, bond, certificate, policy or other instrument, or arising by virtue of any such obligation; and if
  - the plaintiff has deposited such money or property or has paid the amount of or the loan or other value of such instrument or the amount due under such obligation into the registry of the court, there to abide the judgment of the court, or has given bond payable to the clerk of the court in such amount and with such surety as the court or judge may deem proper, conditioned upon the compliance by the plaintiff with the future order or judgment of the court with respect to the subject matter of the controversy.
- Such an action may be entertained although the titles or claims of the conflicting claimants do not have a common origin, or are not identical, but are adverse to and independent of one another.

The stakeholder invoking interpleader must deposit the largest amount for which it may be liable in view of the subject matter of the controversy. *United States Fire Ins. Co. v. Asbestospray, Inc.*, 182 F.3d 201 (3d Cir. 1999).

Service of process is nationwide as to claims to the interpleaded funds. See, 28 USCS § 2361

- Jury Trial

In *Jefferson Standard Ins. Co. v. Craven*, 365 F. Supp. 861 (M.D. Pa. 1973), the court had discharged the interpleading insurance company from further liability, leaving only the ownership of the proceeds at

issue. A jury demand had been filed by one of the claimants. The court found that whether the initial interpleading is to be permitted is an equitable inquiry for the court. The second stage involves the resolution of disputes amongst possible claimants to the fund. The court denied a motion to strike the jury demand, noting that the status of the jury trial was unsettled, but finding support for proceeding with a jury in 3A Moore, Federal Practice § 22.14 [4], at 3114-15.

- Attorney's Fees

A court may deny fees to an interpleader plaintiff if determining the proper payee of benefits falls squarely in the ordinary course of the plaintiff's business and the plaintiff filed the action simply to "free itself from ongoing litigation or the vexation of multiple lawsuits." *Allstate Settlement Corp. v. United States*, No. 07-5123, 2008 U.S. Dist. LEXIS 41700, at \*23-24 (E.D. Pa. 2008) (quoting *Prudential Ins. Co. of Am. v. Richmond*, No. 06-525, 2007 U.S. Dist. LEXIS 48458, at \*4 (D.N.J. July 2, 2007)). The reasoning for this exception is that an award to such a plaintiff "would constitute a shifting of some of the stakeholder's ordinary business expenses to the claimants." *Fidelity Bank v. Commonwealth Marine and Gen. Assur. Co.*, 592 F. Supp. 513, 526 (E.D. Pa. 1984).