Anderson Kill & Olick, P.C.
POLICYHOLDER ADVISOR
The Policyholder Law Firm
Volume 21 Number 6 www.andersonkill.com November/December 2012

Bad Faith Litigation Against Insurance Companies Rages Across the Country

By Robert D. Chesler and Nicholas R. Maxwell

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A rising tide of first-party bad faith decisions is defining the contours of the bad faith cause of action. Policyholders regularly claim bad faith to combat the obstructions and delays too often encountered in the claims handling process. Recently, three courts have found first-party insurance companies liable for bad faith claims handling. However, there are also two recent bad faith decisions in favor of the insurance company. Key aspects of each of these important cases are discussed below. Policyholders with Superstorm Sandy claims should be particularly aware of the evolving state of bad faith law. There is doubt as to whether insurance companies have reserves sufficient to cover all of the Sandy claims, increasing the likelihood of bad faith coverage denials.

Pro-Policyholder Bad Faith Decisions

Delish v. Metropolitan Adjustment Bureau was a case of a fire loss and the claims handler from hell. The original claims handler had hired an adjuster who handled the claim fairly. The new claims handler brought in a new adjuster, and together they made unreasonable demands for information during their 20-month investigation. The claims handler knew that the policyholder was a small company that did not have the resources to rebuild after the fire and was suffering significant hardship and loss of business. The arbitration panel found that "[t]he issue of business interruption losses, which were denied due to a technical failure of proof and accounting losses, would not have been an issue at all had [the insurance company] simply and promptly paid that which was not subject to reasonable dispute." The panel found the insurance company guilty of bad faith, stating that its conduct was "willful and reprehensible."

In *Miller v. Safeco Ins. Co. of America*, the policyholders (homeowners) purchased a house and later found water damage that led to mold and the loss of use of the house. The insurance company denied coverage because the homeowners allegedly had prior knowledge of the water damage. Safeco alleged prior knowledge on the grounds that the policyholders had previously reviewed inspections of the home that suggested existing water damage. However, when the policyholders began to renovate the home after purchasing the policy, they discovered new damage that was significantly worse than anything revealed by past inspections.

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First, the U.S. Court of Appeals for the Seventh Circuit found that there was no prior knowledge

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and that "Safeco lacked a reasonable basis for denial and…demonstrated a reckless disregard of its lack of a reasonable basis. Second, the court rejected Safeco's argument that it could rely on exclusions in the policy, since the Millers had not even received the policy when the damage was discovered. Safeco had argued that even if it acted in bad faith by denying coverage, there would have been no coverage in the first place if the policy exclusions applied, so there could be no bad faith. The Seventh Circuit rejected this argument, calling it "rather iniquitous" for Safeco to argue exclusions that had not even been considered in the original coverage denial.

In *Bello v. Merrimack Mutual Fire Ins. Co.*, a retaining wall on the policyholders' home sustained significant storm damage. The insurance company's claims adjuster sent an individual, who was not an engineer, to inspect and found that the damage to the wall was caused by its preexisting condition. As a result, Merrimack denied the claim. When the homeowners protested to a supervisory employee at Merrimack, the supervisor repeated the denial. However, in an earlier internal memo, the superior had concluded that it was a covered claim. Despite the fact that Merrimack later reversed itself and paid the claim, the New Jersey Superior Court found that Merrimack had acted in bad faith.

Pro-Insurance Company Bad Faith Decisions

In *Millennium Inorganic Chemicals v. National Union Fire Ins. Co. of Pittsburgh, PA*, the policyholder suffered business interruption after an explosion at its facility in Australia. Millennium argued that National Union made its coverage decision prematurely and clearly did "not understand how [its] own policies work." Rejecting the bad faith claim, the U.S. District Court for the District of Maryland, applying New Jersey law, found that the coverage question was "fairly debatable" and thus bad faith could not be shown.

Interestingly, the court held that if National Union were required to cede to its policyholder, it "would never be entitled to test through litigation the merits of a reasonably debatable coverage position." That would require not good faith but rather "rote acquiescence to any [non-frivolous] claim."

In *Palmisano v. State Farm Fire and Cas. Co.*, the policyholders discovered structural issues in their home and determined they were caused by a ruptured sewer main under the house. Plaintiffs alleged, among other things, that State Farm violated its fiduciary duty to them, engaged in an adversarial relationship with them, and failed to fairly and properly investigate the claim.

The U.S. District Court for the Western District of Pennsylvania endorsed a prior court's statement that bad faith claims must show the "who, what, when, why or how" of the insurance company's bad faith. The policyholder's "bare bones" and "conclusory" allegations were insufficient to survive the insurance company's motion to dismiss the bad faith claim.

Lessons Learned from Recent Bad Faith Decisions

Bad faith claims handling does occur, and courts and juries will punish the insurance company that commits it. However, policyholders must carefully document the bad faith conduct and plead it in sufficient detail to meet the legal thresholds courts use to determine whether the cause of action survives a motion to dismiss.

The pro-policyholder cases above also show that the policyholder must be persistent in pursuing its original claim and fighting for its rights. The policyholder should respond to the insurance company's reasonable request for information and build a record of its cooperation in contrast to the insurance company's delay. Most importantly, the policyholder needs to be aware of its rights and pursue them aggressively.

Following best practices in pursuit of any claim will not only expedite and maximize coverage when claims are honored, but also establish credibility for a bad faith claim when insurance company behavior justifies it. A short checklist:

- ✓ **Provide immediate notice.**
  Late notice can result in the forfeiture of coverage. Immediate notice to any potentially involved insurance company is essential.
- ✓ **Fulfill your duty to cooperate.**
  Often, in the aftermath of a catastrophe, the insurance company is the last person that the policyholder has time for. However, the policyholder has a duty to cooperate that the courts take seriously. Do not put the insur-

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ance company off until everything else is done. Responding to the insurance company must be a priority. Moreover, the insurance company cannot analyze your claim without the necessary information. Delaying a response to the insurance company will delay the resolution of your claim.

- ✓ **Be sensitive to delays.**
  Most insurance companies handle most claims in good faith. Some delay in the process may be unavoidable, and as noted earlier, the insurance company may need a lot of information from you. However, when the delay goes on for too long, or the requests for information become oppressive, think bad faith.
- ✓ **Engage an insurance professional.**
  Property insurance claims are highly technical, and require substantial analysis.

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Crazy Schemes: Orion and London & Overseas Insurance Companies

By Mark Garbowski

Policyholders with London Market insurance policies are probably familiar with the U.K. schemes for winding up the affairs of both insolvent and sometimes solvent insurance companies. One such scheme expects to wind up next year with a handful of twists that merit special attention, including for policyholders who are absolutely certain that they have no claims and will never have claims against the insolvent company seeking to conclude its affairs. In fact, policyholders whose habit is to ignore U.K. schemes of arrangement should review the scheme details and decide whether to engage this time.

The U.K. Scheme Process: Overview and Background

Generally, London Market insurance companies seeking to wind up their affairs use a "scheme" process. This is similar in some ways to U.S. liquidation procedures, but usually moves much faster. In sum, once an inactive insurance company sets up the scheme and it is approved by a court, a scheme plan is adopted and soon thereafter dates are set requiring policyholders and other claimants to submit and provide evidence for their claims by a certain date. Because this usually happens fairly quickly, the schemes typically allow for the submission of future expected claims. These usually involve, but are not limited to, environmental or asbestos-type claims that the policyholder already faces and expects to keep facing into the future.

In addition to moving more quickly than similar U.S. proceedings, the U.K. version differs in at least one additional, significant way. In the United States, generally only insolvent insurance companies are liquidated. In the United Kingdom, solvent companies can take advantage of the same scheme process to wind up their affairs, and force policyholders who purchased occurrence-based policies that would otherwise remain available indefinitely into the future, to estimate and justify their future claims today. If new claims turn up unexpectedly after the claim is required to be submitted and disposed of, the policyholder will not be able to recover from that company.

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Solvent companies in the United Kingdom can take advantage of this process in two ways. First, solvent companies that have ceased writing new policies (aka being in run-off) can apply for a scheme to wind up their affairs. Second, solvent and active companies can dispose of a limited part of their business, if it was written as part of a pooling arrangement and insolvent members of the pool are setting up a scheme. Then the solvent company can opt to go along for the ride, and either require or allow policyholders submitting claims against the insolvent scheme to also submit claims against the solvent portion of the same pool.

The Orion and London & Overseas Insurance Company Insolvent Scheme

Orion Insurance (now known as OIC Run-Off Limited) and London & Overseas Insurance are currently in an insolvent scheme with a solvent adjunct. At the time of this article, no dates have been firmly set, but the scheme administrators currently expect a bar date sometime in 2013 with a policyholder/creditors vote in June 2013. Policyholders who have not perfected their claims should become aware of these upcoming dates as they become settled, and those with already approved claims who have been receiving partial payments should also determine if they need to engage in next year's events.

The solvent adjunct to the insolvent portion is being handled in a novel fashion that will require policyholders to make decisions that are not common in these schemes.

In brief, policyholders with claims against the solvent portion can opt not to pursue future claims against the solvent portion at this time, and retain their solvent coverage, but if they do submit them, they will get the solvent portion of their future claims paid with no present value discount plus a 10% bonus. On the other hand, if more than 30% of the solvent scheme portion (as measured by claim value) does opt out, then the entire scheme is abandoned and even the insolvent companies will simply remain in run-off. As a further complicating factor, policyholders with no currently expected claims against either the solvent or insolvent portion of the scheme would have to submit their decision to opt out in order to retain the potential future value of their solvent policies that were part of the pool. Accordingly, policyholders who routinely ignore U.K. schemes, but who have London Market policies in which with Orion or London & Overseas participate, should review the scheme details and decide whether to engage in the process this time. Finally, if this scheme is successful, we can expect future schemes to copy and perhaps build upon this formula.

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