

**POST LITIGATION BAD FAITH –
THE POTENTIALLY ERODING DEFENSE OF THE INSURER**

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For years Pennsylvania law has defined the bad faith cause of action based upon the terms of 42 Pa.C.S.A. ' 8371, which provides as follows:

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

- (1) 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 three (3) percent.
- (2) Award punitive damages against the insurer.
- (3) Assess court costs and attorney fees against the insurer.

Historically, the policyholder alleges conduct during the claim process amounts to bad faith, entitling the policyholder to extra-contractual damages provided for in ' 8371. The carrier then retains counsel to defend the bad faith action. The defense provided is often vigorous and confrontational, particularly as it pertains to discovery relating to insurance documents and information that is not specific and unique to the particular claim at issue.

In recent years, policyholders have asserted the carrier has acted in bad faith through its assigned counsel during the litigation process itself. I anticipate that this trend will continue to grow as Uninsured and Underinsured's claims are litigated contemporaneous with allegations of bad faith

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surrounding the claim's handling and failure or refusal to settle. Litigation bad faith claims present new concerns for the carrier as they potentially extend the "claim" process through litigation, in addition to focusing greater scrutiny to the manner in which the bad faith litigation is defended.

The door to post litigation bad faith in Pennsylvania was opened in O'Donnell v. Allstate Insurance Company, 734 A.2d 901 (Pa. Super. 1999) and subsequently in Ridgeway v. United States Life Credit Life Insurance Company, 793 A.2d 972 (Pa. Super. 2002). Although neither O'Donnell nor Ridgeway were cases in which the courts found that the specific post litigation conduct at issue constituted bad faith, the O'Donnell Court, in addressing a claim by the plaintiff that "frivolous" discovery requests by the defendant constituted evidence of bad faith, stated "the plain language of ' 8371 clearly reveals the lack of any restrictive language limiting the scope of bad faith conduct to that which occurred prior to the filing of a lawsuit." O'Donnell, 734 A.2d 906. The Court went on to state "the conduct of an insurer during the pendency of litigation may be considered as evidence of bad faith under ' 8371." Id. 907.

It is likely that bad faith was not found in either O'Donnell and Ridgeway because the allegations of post litigation bad faith centered entirely around discovery issues. Thus, while the plaintiffs in both cases argued that the discovery was "frivolous" and designed to harass the plaintiff policyholder, the lower court found and the Superior Court affirmed in both cases that the Pennsylvania Rules of Civil Procedure provide the plaintiff with a remedy for improper discovery including discovery designed to harass another party. While it is clear that disputes over discovery including potentially the manner in which discovery is conducted do not constitute evidence of bad faith, conduct engaged in during the litigation of the bad faith claim that exceeds mere discovery matters can and likely will serve as evidence of bad faith itself.

In Hollock v. Erie Insurance Exchange, 842 A.2d 409 (Pa. Super. 2004), the trial court found multiple instances of conduct by the defendant during the litigation process which it characterized as an intentional attempt to conceal, hide or otherwise cover-up the conduct of (the insurance company) employees@ Hollock 842 A.2d 415. Specifically, the trial court found instances of bad faith conduct not only in the litigation of the underlying Underinsured Motorist Claim, but also in the defense of the insurance company in the bad faith action filed after the Underinsured Motorist Arbitration award was entered. The Hollock court determined that the insurance company received information during the defense of the Underinsured Motorist Claim which should have caused the

carrier to reevaluate its settlement position, but which the court found was actually not considered at all. The court also determined that the insurance company's defense counsel made repeated requests for information that had already been provided to the insurance company solely for purposes of delaying the claim so that the insurance company could put the plaintiff under surveillance. Finally, and perhaps most significantly, the court determined that trial testimony in the bad faith case by representatives of the insurance company was nothing more than a ruse to try to hide the actions of the insurance company's claims handlers during both the claim process and the litigation of the Underinsured Motorist Claim.

The Superior Court in Hollock was ultimately convinced that the insurance company acted in bad faith in the handling of the Underinsured Motorist Claim. For this reason, it is difficult to predict the extent to which what the court perceived as a false testimony during the defense of the litigation claim influenced either the finding of bad faith or the amount of damages awarded. The Superior Court in Hollock, at a minimum, reaffirmed that in Pennsylvania the actions of the defendant insurer and possibly those of defense counsel, in defending a bad faith case constitute evidence of bad faith.

The federal courts applying Pennsylvania law have also made it clear that post litigation conduct can be evidence of bad faith. In fact, the federal courts have gone farther than the state appellate courts in defining what post litigation conduct might evidence or constitute bad faith. In Schmitt v. State Farm Insurance Company, 2011 U.S. Dist. LEXIS 105834 (W.D. Pa. 2011), the Federal Court for the Western District of Pennsylvania held that when new evidence pointing to the existence of coverage is unearthed during the defense of the bad faith litigation and is not considered by the carrier, this is evidence of bad faith. The court was careful to note, however, that it remains the plaintiff's burden to establish by clear and convincing evidence that post litigation conduct amounts to bad faith. An allegation by the insurer that the plaintiff's underlying claim was fraudulent as a way of establishing a reasonable basis for denying the claim in the first instance does not and cannot constitute evidence of bad faith in the absence of clear proof by the policyholder that the insurer lacked a reasonable basis for the defense.

In Little Souls, Incorporated v. State Auto Mutual Insurance Company, 2004 U.S. Dist. LEXIS 4569 (M.D. Pa. 2004), the Middle District stated that, while the filing of a declaratory

judgment action seeking to have the court declare that there is no coverage cannot alone sustain an action for bad faith, if the policyholder is able to prove that statements made in conjunction with the declaratory judgment action are false, the statements will constitute evidence of bad faith. This would seem to be primarily true because the false statements by the carrier are made solely for the purposes of avoiding or attempting to avoid an insurance obligation to the policyholder.

Most alarming is the fact that post litigation bad faith conduct can even potentially extend to defenses raised in the defendant=s pleadings. In Krisa v. The Equitable Life Assurance Society, 109 F. Supp. 2d 316 (M.D. Pa. 2000), applying the analysis set forth by the Superior Court in O=Donnell, Supra, the Court found that the insurance company defendant wrongfully responded to the plaintiff=s bad faith complaint by asserting a counterclaim alleging that the plaintiff had committed fraud in his application for disability insurance. Krisa involved a motion to dismiss the complaint in a second bad faith action which was based solely upon the counterclaim the first bad faith action. Thus, the issue was not whether the plaintiff had come forth with clear and convincing evidence that the false statements in the counterclaim constituted bad faith but, rather, whether the allegations by the plaintiff if proven could not, as a matter of law, constitute bad faith. The Krisa Court held that, because the plaintiff=s allegations of misconduct went well beyond allegations of mere discovery disputes, the plaintiff=s complaint based upon the defendant=s counterclaim stated a viable bad faith claim.

It is evident that at least in Federal Court in Pennsylvania all statements contained in pleadings might constitute evidence of bad faith by the insurance carrier. Krisa would appear to be limited to Afalse, baseless and fraudulent@ statements made by the defendant insurance company in an affirmative counterclaim in which the carrier seeks to recover damages from the plaintiff. The courts appear to draw no distinction and hence it would not appear to be any requirement for a potential finding of bad faith that the insurance company direct defense counsel as to specific allegations contained in pleadings or as to specific conduct in the course of defending the carrier in the bad faith case. It is certain that it is no longer the case in Pennsylvania that potential Abad faith@ conduct applies only to the claims handling process. It is recommended, therefore, that insurance carriers remain active and involved with defense counsel throughout the course of defense in both bad faith cases and first party claims against the carrier so as to minimize potential false statements

and duplication of efforts in the claims handling and litigation. Claims handlers and litigation consultants within the insurance company should also be mindful that their actions during litigation are potentially relevant and admissible in any potential subsequent bad faith action.