

# **Identifying The Type Of Tort, Related Causes Of Action And Damages**

**Updated by Jonathan MacBride**

- First-Party And UM/UIM Claims
- Third-Party Claims
- Exploring Related Causes Of Action
- What to Consider When Figuring Damages

**National Business Institute  
“Bad Faith Insurance Claims in Pennsylvania”**

**Allentown, Pa July 22, 2008**

A. **First-Party and UM/UIM Claims**

1) ***Terletsky v. Prudential Property and Cas. Ins. Co.*, 649 A.2d 680 (Pa. Super. 1994) (Kelly, J.), appeal denied, 540 Pa. 641, 659 A.2d 560 (Pa. 1995): Elements of bad faith claim under 42 Pa. C.S.A. §8371 are lack of reasonable basis for insurer's conduct and knowledge or reckless disregard for lack of reasonable basis. Clear and convincing standard of proof applied.**

In *Terletsky v. Prudential*, the plaintiffs, who were husband and wife, alleged that their insurer had acted in bad faith by offering only \$40,000 and \$17,000 in settlement of their respective uninsured motorist claims, and subsequently delaying payment of a portion of the husband's \$125,000 arbitration award by contending that stacked coverage was unavailable to him.

The trial court decided the bad faith claim in favor of the husband and against the wife. The Superior Court, reversing the decision in favor of the husband, set forth the elements of a bad faith claim under 42 Pa. C.S.A. §8371: "[T]o recover under a claim of bad faith, the plaintiff must show that the defendant did not have a reasonable basis for denying benefits under the policy and that defendant knew or recklessly disregarded its lack of reasonable basis in denying the claim." *Id.* 649 A.2d at 688. Furthermore, the court held that bad faith claims must be proven by clear and convincing evidence. *Id.*

The court then held that the insurer had a reasonable basis for its settlement offers to both plaintiffs because there was conflicting evidence as to the severity of their injuries, and the liability of the uninsured motorist was not clear. The court further held that the insurer had a reasonable basis to question whether stacked coverage was available, because Pennsylvania law on stacking was unsettled at that time.

**2) *Klinger v. State Farm Hut. Auto. Ins. Co.*, 115 F.3d 230 (3d Cir. 1997) (Nygaard, J.): Proof of improper purpose, self interest, or ill will is not required in a §8371 claim.**

In *Klinger v. State Farm*, the plaintiffs alleged the insurer acted in bad faith by failing to make reasonable settlement offers in their underinsured motorist claims. The jury returned verdicts for the plaintiffs, and the insurer argued on appeal that the trial court had incorrectly instructed the jury on the elements of bad faith. Specifically, the insurer alleged that the Blacks Law Dictionary definition of bad faith quoted in *Terletsky v. Prudential* required proof that the insurer was motivated by an improper purpose such as ill will or self interest.

The Court of Appeals for the Third Circuit held that no such showing was required: "We will rely on the actual test that *Terletsky* applied and refrain from creating a third part based only on dictum quoted from Blacks Law Dictionary." *Id.* at 234. The court then determined that the evidence was sufficient to support a finding that the insurer lacked a reasonable basis for failing to make reasonable settlement offers, and recklessly disregarded that fact. *Id.*

**3) *W.V. Realty, Inc. v. Northern Insurance Company of New York*, 334 F.3d 306 (3<sup>rd</sup> Circuit 2003). Discovery violations alone cannot be the basis for allegations of bad faith.**

In *W.V. Realty, Inc. v. Northern Insurance Company of New York* plaintiff's had successfully obtained a bad faith verdict against the insurer and received an award of punitive damages, attorneys' fees, costs and interests. However, on appeal, the Third Circuit found that the admission into evidence of discovery violations on the part of the insurer, including the trial court's opinion awarding costs against the insurer was reversible error. The Court found that Pennsylvania Courts had declined to find bad faith

based on nothing more than discovery violations. The Court recognized that Pennsylvania law recognizes that bad faith can occur after the institution of suit, but that in those cases the bad faith was based on conduct during suit that involved something more than merely the discovery violations and the conduct suggested was intended on the part of the insurer to evade its obligations under the insurance contract.

Furthermore, the Court held that while there may have been a factual basis for a finding of bad faith there was no basis for an award of punitive damages. In citing Section 908 of the Restatement (2<sup>nd</sup>) of Torts, which has been adopted by Pennsylvania, the Court found that punitive damages may be “awarded to punish defendant for outrageous conduct, which is defined as an act which, in addition to creating actual damages, also imports insorter outrage, and is committed with a view to oppress or is done in contempt of plaintiff’s rights. Both intent and reckless indifference will constitute a sufficient mental state.” (citing *Klinger v. State Farm Mutual Auto Insurance Company*, 115 F.3d 230, 235 (3<sup>rd</sup> Circuit 1997) *Id.* at 318. The Court found that its case was distinguishable from *Klinger* because neither liability nor the amount of damage was clear. Although, the Court conceded that the insurance company may not have handled the dispute appropriately, there were legitimate disputes over liability and valuation.

**4) Oehlmann v. Metropolitan Life Insurance Company, 2007 WL4563522 (M.D. Pa. 2007). District Court finds that evidence of violations of UIPA and UCSP are irrelevant in determining whether an insurers conduct constitutes bad faith.**

In *Oehlmann v. Metropolitan Life Insurance Company* the plaintiff brought suit alleging bad faith conduct on the part of the defendant in a dispute between divorced

parents over the proceeds of a life insurance policy for a deceased child.

The plaintiff argued that the District Court should consider alleged violations of the Pennsylvania Unfair Insurances Practices Act (“UIPA”) and/or the Unfair Claims Settlement Practices (“UCSP”) regulations when determining whether the defendant acted in bad faith. The District Court appears to have rejected plaintiff’s argument that violations of the UIPA and UCSP are relevant to determining whether the insurer acted in bad faith.

The District Court found that since *Terletsky v. The Prudential Property and Casualty Insurance Company* 437 Pa.Super 108 (Pa. Super. 1994) was decided, Federal Courts sitting in diversity, have abstained from relying on violations of the UIPA or UCSP as evidence of bad faith.

The District Court adopted the Third Circuit’s opinion in *Dinner v. United Services Auto Association Casualty Insurance Company*, 29 Fed. Appx. 823 (3<sup>rd</sup> Circuit 2002) in rejecting the argument that violations of the UIPA and UCSP are bad faith per se. The District Court found that the only standard for determining legal bad faith in § 8371 actions is the Terletsky test. The court found, therefore an insurer’s alleged violations of a regulatory standard would be irrelevant to their analysis.

However, even though the Court apparently rejected using alleged violations of the UIPA and UCSP as evidence to be considered in determining the bad faith conduct of the defendant the Court goes on to say that they are aware of the standards laid out in the UIPA and UCSP and have considered the defendant’s conduct in light of them.

5) ***Condio v. Erie Ins. Co.*, 899 A.2d 1136 (Pa. Super. 2006) (Hudock, J.), appeal denied, 590 Pa. 668 (2006): Insurer does not have a heightened duty of good faith to its insured in the context of a first party claim. Insurer cannot withhold payment of UIM claim without a reasonable basis for doing so.**

In *Condio v. Erie Insurance Co.*, the insured's estate made a claim for UIM benefits following a single car accident. A critical issue in the case was who was driving the automobile because the policy contained an excluded driver endorsement which specifically excluded coverage for the decedent. The insurer denied coverage, asserting that the decedent was operating the vehicle at the time of the accident. The case first went to arbitration, where the arbitrators found that the estate met its burden of proof that the decedent was not the driver of the car, and awarded the policy's limits plus interest. The estate then filed a lawsuit alleging bad faith under §8371, asserting that the insurer's investigation into the facts of the accident was deficient. The trial court granted the insurer's motion for summary judgment, and the estate appealed to the Pennsylvania Superior Court. The Superior Court reversed and remanded. On remand and after a bench trial, the trial court concluded that the insurer acted in bad faith, and both parties appealed.

On appeal, the Superior Court initially noted that a UIM claim has components of both first and third party claims and held that, in any event, an insurer does not have a heightened duty of good faith to its insured in the context of a first party claim, as opposed to a third party claim. "Pennsylvania law holds insurers to a duty of good faith and fair dealing toward their insureds... without distinguishing between first and third party settings... U-claims contain elements of both first party and third party claims. We see no reason, therefore, to impose a different duty on an insurance company in a U-claim setting. While the legal relationship of the parties may change in the context of a

U-claim, i.e., become adversarial, the insurer's duty does not change." *Id.* at 1145.

The Superior Court reversed the trial court's decision, finding that the insurer's investigative conduct did not support a claim of bad faith since a more thorough investigation by the insurer would have been premature to its exposure, redundant to efforts in preparing for the arbitration, and duplicative of the investigations undertaken by the police.

**6) *Kakule v. Progressive Cas. Ins. Co.*, 2007 WL 1810667 (E.D. Pa. 2007) (Kelly, J.): A Pennsylvania first-party bad faith plaintiff is not limited to statutory claims; it may also assert common law contract claims for its insurer's bad faith conduct.**

In *Kakule*, the insured contended that his UIM carrier improperly delayed and/or refused to pay policy limits. After invoking his appraisal option under the contract, an arbitration panel assessed his damages in excess of policy limits. The insurer then paid the policy limit. The insured subsequently filed suit, alleging, among other things, statutory bad faith and common law bad faith/breach of contract based upon the insurer's delay of payment.

On a motion to dismiss, Judge Kelly originally dismissed the insured's breach of contract cause of action on the grounds that Pennsylvania common law precluded such recovery in the context of first party claims. On reconsideration, however, he reversed that decision and held that a first-party claimant is *not* limited to statutory relief, but can recover under a breach of contract theory as well. The practical impact of the Court's decision was that the *Kakule* plaintiff could recover compensatory damages for the insurer's alleged bad faith, which are otherwise not provided for under the statute.

In reaching his decision, Judge Kelly relied upon the Supreme Court's decision in *The Birth Center v. St. Paul Cos., Inc.*, 567 Pa. 286, 787 A.2d 376 (2001), which recognized a common law cause of action for bad faith under a breach of contract theory in the third-party context. The judge interpreted this case to apply equally to first-party and third-party bad faith actions, despite the fact that numerous Pennsylvania courts have explicitly held that a first-party bad faith claimant has no common law right to recovery and his remedies are limited by the statute. In doing so, the judge distinguished the Supreme Court's decision in *D'Ambrosio v. Pa. Nat. Mut. Cas. Co.*, 494 Pa. 501, 431 A.2d 966 (1981) (which held that Pennsylvania common law would not recognize a bad faith tort as other states had) on the ground that it only spoke to a bad faith tort -- not a breach of contract action. Judge Kelly also concluded that the *Birth Center* Court could have limited its holding to third-party claims -- but chose did not do so, even when distinguishing *D'Ambrosio*, which arose in the first-party context.

**7) *Connolly v. Reliastar Life Ins. Co., Inc.*, 2006 U.S. Dist. LEXIS 83440 (E.D. Pa. Nov. 13, 2006): (Joyner, J.): Disability insurer's conduct in seeking reimbursement from its insured under the terms of a Reimbursement Agreement did not constitute bad faith under Section 8371, because the Agreement was not an insurance policy. Likewise, in this context, insurer does not owe the insured a fiduciary duty.**

The plaintiff filed a claim for long-term disability benefits. In order to avoid difficulties relating to the reduction of policy proceeds based upon a presumed receipt of "other income benefits," plaintiff entered into a Reimbursement Agreement with the defendant insurer, pursuant to which she was to reimburse the insurer upon receiving other income benefits. A collection action by the insurer ultimately ensued. While the insured settled the collection action for the full amount demanded by the insurer, the insured then brought a separate lawsuit against the insurer, citing violation of Section

8371 (along with a slew of other counts for breach of contract, breach of the implied duty of good faith and fair dealing, breach of fiduciary duty, and violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law) relating to the insurer's conduct in investigating, attempting to collect moneys owed, and then litigating the collection action with regard to the Reimbursement Agreement.

On summary judgment, the court dismissed the insured's entire complaint with prejudice. Regarding the bad faith claim, the court found that the insured had no right to bring a claim pursuant to §8371 because the statute only applies to actions arising under an insurance policy. In this case, the contract at issue was a Reimbursement Agreement. As the plaintiff introduced no evidence that the insurer acted in bad faith regarding the insurance policy itself, the court concluded that the plaintiff lacked the basis for a bad faith claim. The court dismissed plaintiff's claim for breach of the implied duty of good faith and fair dealing for lack of evidence, but not before suggesting the following in dicta: (1) that it is still unsettled in Pennsylvania contract law - especially in cases of insurers dealing with insureds - whether a claim for breach of the implied duty of good faith and fair dealing can be successfully maintained if there is no breach of contract; (2) that cases suggest that it is the relationship (insurer-insured), rather than the nature of the contract, that gives rise to an implied duty of good faith; and (3) that, in the Court's view, a bad faith claim sounding in contract might only require a "preponderance of evidence" to succeed.

The court dismissed the UTPCPL and deceit counts for failure to prove fraud on the part of the insurer. Finally, the court found that the plaintiff's breach of fiduciary claim was also without merit, recognizing that the duty only exists in limited

circumstances, such as "where an insurer asserts a right to defend claims against the insured." In this context, the court concluded that there was no fiduciary duty because the insurer was in an adversarial position to the insured.

**8) *Barry v. Ohio Casualty Group*, 2007 U.S. Dist. LEXIS 2684 (W.D. Pa. Jan. 12, 2007) (Gibson, J): An insurer's entire course of conduct, including delay of payment (as opposed to a particular incident or denial of claim) can be considered in order to determine whether UIM claim was conducted in bad faith.**

In *Barry v. Ohio Casualty Group*, both parties moved for summary judgment in a suit arising from the defendant's alleged bad faith in handling the plaintiff's claim under her auto insurance policy. The policy covered \$100,000 for medical expenses and \$25,000 in stacked uninsured motorist (UIM) coverage. In March 2001, the plaintiff was involved in a two-car accident in which the other driver was primarily at fault. After receiving plaintiff's notice of claim regarding medical expenses, her insurer began paying almost immediately. However, in response to plaintiff's notice of request for UIM benefits several months later, the insurer delayed almost a year in providing an offer. When it finally did, it was nominal, and only after the insurer conducted a medical examination did the insured receive the UIM limit.

The plaintiff argued that the insurer acted in bad faith by failing to investigate her claim, engaging in low-ball tactics, attempting to raise a frivolous defense, engaging in unreasonable delay, and allowing its legal counsel to engage in improper conduct. Citing cases that purport to have extended Section 8371 relief to claims for unreasonable delay of payment, insurer investigative practices, and failure to communicate with the insured, the court noted at the outset that the bad faith claim was not precluded as a matter of law simply because the insurer eventually honored the plaintiff's claim. The court then denied both motions, finding that while the insured had provided sufficient evidence to enable a

reasonable jury to find bad faith, the defendant had likewise presented sufficient evidence to preclude the granting of summary judgment in favor of the plaintiff. In so doing, the court predicted that while the insured's bad faith claim did not rest on a single incident or denial of claim and while it was not entirely clear "whether the Pennsylvania courts would parse through this detailed fact pattern, distinguishing between those actions that could demonstrate bad faith and those that could not," the Pennsylvania Supreme Court would hold that "the entire course of conduct" throughout the claims handling process could be considered in determining whether the insurer had violated Section 8371.

**9) Stephano v. Tri-Arc Financial Services, Inc., 2008 WL 625011 (M.D. Pa. 2008). Not all allegations of statutory bad faith arising from a claim for reimbursement of medical benefits are pre-empted by section 1797 of the MVFRL.**

In *Stephano v. Tri-Arc Financial Services, Inc.* the plaintiff sued the defendants for failing to pay first party benefits to reimburse a third party beneficiary's medical expenses for injuries relating to a motor vehicle accident.

Defendant Lexington had filed a Motion to Dismiss arguing that plaintiff's bad faith claim was pre-empted by 74 Pa. Cons. Stat. § 1797. Lexington argued that Pennsylvania's bad faith statute 42 Pa. Cons. Stat. § 8371 and 75 Pa. Cons. Stat. § 1797 conflicted irreconcilably and therefore the special provisions in § 1797 should prevail.

However, the Federal Court recognized that a § 8371 claim may not be pre-empted when an insurance company's alleged malfeasance goes beyond the scope of § 1797 or is not amenable to resolution by the procedure set forth in § 1797.

Section 1797 sets up a peer review plan by which an insurer can challenge the reasonableness and necessity of an insured's treatment and allows for a third party peer review organization to review a patient's treatment to confirm that the treatment was

appropriate and necessary.

The Federal Court found that the allegations contained in plaintiff's Complaint against Lexington were not related to Lexington's improper actions under § 1797 but were related to Lexington's simple denial for coverage under the policy. Therefore, the Court found that this case is not a case that falls under the province of § 1797 and therefore allowed plaintiff's § 8371 claim to proceed.

## **B. Third-Party Claims**

**1) *The Birth Center v. The St. Paul Companies*, 787 A.2d 376 (Pa. 2001) (Newman, J.): Insured may recover compensatory damages in common law claim for breach of duty of good faith; emotional distress damages may be recoverable in appropriate case.**

In *The Birth Center v. The St. Paul Companies*, the plaintiff alleged that the insurer acted in bad faith by refusing to settle an underlying medical malpractice action brought against the plaintiff, in which the jury returned a verdict in excess of the plaintiffs' insurance limits. The insurer paid the entire amount of the verdict against the plaintiff, but the plaintiff alleged that the insurer's bad faith conduct also caused the plaintiff to incur additional compensatory damages of \$700,000.

In the trial of the bad faith case, the jury awarded the plaintiff the \$700,000 in additional compensatory damages. The insurer requested a judgment notwithstanding the verdict, and the trial court granted this motion on the following grounds: (1) that the jury was not charged on breach of contract; (2) compensatory damages were not recoverable under §8371; and (3) the insurer's payment of the excess verdict nullified the bad faith claim in any event. The Superior Court reversed, and the Supreme Court, upholding the reversal, held that:

- (1) the trial court had charged the jury on breach of contract;
- (2) there was sufficient evidence to support the breach of contract verdict;
- (3) the insurer's payment of the excess verdict did not preclude an award of additional compensatory damages because the damages stemming from the insurer's bad faith conduct were not resolved in the action against the plaintiff; and
- (4) § 8371 does not preclude an award of compensatory damages for breach of contract because Section 8371 merely provides additional remedies to a party's common law contract remedies, and does not alter them.

After recognizing a common law claim for breach of contract in bad faith cases, the court in *Birth Center* held that compensatory damages are recoverable on such a claim. Justice Newman stated, at the outset of her opinion, that "the insurer is liable for the known and/or foreseeable compensatory damages of its insured that reasonably flow from the bad faith conduct of the insurer." The court's reasoning on this issue was straightforward: common law claims for breach of contract are allowed in bad faith cases; compensatory damages are allowed in breach of contract claims; and compensatory damages are thus allowed in breach of contract claims in bad faith cases. As Justice Newman wrote: "The purpose of damages in contract actions is to return the parties to the position they would have been in but for the breach .... Therefore, where an insurer acts in bad faith, the insured is entitled to recover such damages sufficient to return it to the position it would have been in but for the breach."

The court rejected the argument that § 8371, with its express provision only for punitive damages, interest, attorneys fees, and costs, precluded by implication the

recovery of compensatory damages. § 8371, the court held, merely adds its enumerated remedies to those remedies traditionally recoverable under a common law contract claim. It precludes none of those traditional remedies.

The *Birth Center* court also suggested, albeit in dicta, that compensatory damages for emotional distress are recoverable in the appropriate case, noting that "we expressly stated (in *D'Ambrosio*) that, in an appropriate case, an insured could recover compensatory damages based on a contract cause of action, because of an insurer's bad faith conduct."

Under the Restatement (Second) of Contracts, § 353, which the Supreme Court cited favorably (under the provision's prior Restatement designation as § 367) in *D'Ambrosio*, 494 Pa. at 509, 431 A.2d. at 970 n.5, damages for emotional distress may be recovered either where there is also bodily injury or where the emotional distress is a serious and likely result of the defendant's conduct. *D'Ambrosio* and *Birth Center*, therefore, appear to allow for the recovery of damages for emotional distress in bad faith cases under a breach of contract claim, even where there is no bodily injury, if the emotional distress is a serious and likely result of the defendant's conduct.

**2) *T.A. v. Allen*, 868 A.2d 594 (Pa. Super. 2005) (Popovich, J.): Judgment creditor may not pursue bad faith claim in garnishment proceedings absent assignment; two year limitations period applies to statutory bad faith claims; third-party bad faith claim fails where no coverage exists or claim is resolved in favor of insured.**

In *T.A. v. Allen*, the minor plaintiffs alleged that their grandfather had sexually abused them and their grandmother had failed to protect them from such abuse. The grandparents were insured under a homeowners' policy that excluded claims for intentional bodily injury. The insurer filed a declaratory judgment action in 1990, naming

both the grandparents and the plaintiffs as parties. The plaintiffs alleged in new matter that the insurer had refused in bad faith to settle their claims, but the court severed and stayed the bad faith claims.

In 1992, the plaintiffs obtained a verdict and judgment against both grandparents, but the judgment against the grandmother was reversed in 1995. The grandfather refused to grant the plaintiffs an assignment of his claim against his insurer. Thus, in 1997, the plaintiffs instituted a garnishment action against the insurer, which was stayed pending resolution of the declaratory judgment action.

The declaratory action was ultimately resolved in 1998 by the Superior Court, which held that the policy provided no coverage for the alleged intentional acts of the grandfather, but provided coverage for the alleged negligent acts of the grandmother. On April 4, 2002, after the grandfather's death, his estate granted the plaintiffs an assignment, and the stay of the bad faith and garnishment claims was lifted. The insurer thereafter moved for summary judgment on both claims based on the statute of limitations. The court granted that motion in January 2004.

On appeal, the Superior Court affirmed, holding initially that the plaintiffs could not pursue a "bad faith" suit via a garnishment action without a written assignment of rights from the insured. The court noted that plaintiffs' garnishment action had been pending at the time of its decision in *Brown v. Candelora*, 708 A.2d 104 (Pa.. Super. 1998), and thus was controlled by that decision. The court further added that the garnishment action lacked merit because it had been determined that the insurer had no duty to provide coverage for the grandfather, and the claim against the grandmother had been resolved against the plaintiffs. The court further held that if the plaintiffs' bad faith

claims based on the assignment were deemed to relate back to their original pleading in 1992, those claims were filed well within the two year statute of limitations recently set forth in *Ash v. Continental*, 861 A.2d 979 (Pa. 2004). Those claims, nevertheless, lacked merit because there was no coverage for the grandfather, and the grandmother had prevailed on the merits.

**3) Blum v. St. Paul Travelers Insurance Company, 2007 WL221 3597 (Ed. Pa. 2007). Federal Court did not have to relinquish jurisdiction of federal bad faith action even if underlying state declaratory action case could potentially make the federal case moot.**

In *Blum v. St. Paul Travelers Insurance Company* the Plaintiff had taken an assignment of rights from a Travelers policyholder in satisfaction of an arbitration judgment. The Plaintiff had instituted a State Court garnishment proceeding against St. Paul Travelers. The Plaintiff then instituted the Federal Court bad faith case alleging that Travelers acted in bad faith when it refused to make a reasonable settlement offer in connection with the State Court action. Travelers moved to dismiss Plaintiff's Complaint because of the pending State Court action.

The Federal Court held that the State and Federal cases were not parallel within the meaning of that term in *Colorado River Water Conservation District v. United States*, 420 U.S. 800 (1976). The Court found that the central question in the State Court action was whether Travelers must provide coverage for plaintiffs claims. In contrast, the Federal Court case dealt with the manner in which Travelers conducted itself in litigating the State Court action. The Court further found that although a verdict in the State Court action could have the effect of mooting the Federal Court claims, it will not necessarily resolve all of the claims in the Federal Court action. Therefore, the Court held that the

cases are not parallel and it would not relinquish jurisdiction.

**4) *Daniel P. Fuss Builders-Contractors Inc. v. Assurance Co. of America*, 2006 U.S. Dist. LEXIS 56742 (E.D. Pa. 2006) (Schiller, J.): Court holds that bad faith claim cannot be asserted where insurer settles third party claim within the policy limits and no excess verdict is entered.**

In *Daniel P. Fuss Builders-Contractors Inc. v. Assurance Co. of America*, the plaintiff brought claims for breach of contract, statutory bad faith, and breach of fiduciary duty, alleging that the insurer acted in bad faith by delaying settlement of a third party claim brought against it and, that as a result of this delay, the insured had lost business and related profits. During construction work in the basement of a home, plaintiff had failed to build a sufficient berm to retain excess water runoff, and the house ultimately sustained flooding damage. The plaintiff admitted his negligence, and the homeowner retained the plaintiff to repair the damage. The plaintiff subsequently notified his insurer and, thereafter, the homeowner filed suit. The insurer provided plaintiff with a defense, but throughout the litigation, the plaintiff asserted that he was negligent in constructing the berm. On the eve of trial, the case settled for a fraction of the policy's \$1 million limit of liability.

On a motion to dismiss, the insurer argued that the plaintiff's claims were time-barred and that no cause of action for bad faith (statutory or common law) exists when an insurer settles a third party claim within the policy limits and before an excess verdict is entered. The court noted that this was a novel issue, and that "[g]enerally, courts have recognized bad faith actions stemming from an insurer's denial of coverage, delay of payment of a first party claim, or refusal to settle a third party claim which results in an excess verdict." The court noted that in addressing "first-party claims or under-insured

motorist claims, both the Pennsylvania Superior Court and the Third Circuit Court of Appeals have interpreted Section 8371 to include delay of payment by an insurer."

However, the court found no Pennsylvania state or federal case law recognizing a cause of action for the delay of payment of a third party claim.

The plaintiff relied heavily on *Birth Center*, arguing that it "eliminated the prerequisite of an excess verdict to establish a statutory or contractual bad faith claim for unreasonable failure to settle a third party claim." The court rejected this argument, favoring the more narrow interpretation advanced by the insurers. According to the court, "[t]he Pennsylvania Supreme Court did not address an insurer's *delay* in settling a third party claim in *Birth Center*, but instead it maintained the insured's right to recover compensatory damages for contractual bad faith when its insurer unreasonable *refused* to settle such claim. The Pennsylvania Supreme Court simply did not address the situation the Court confronts here, nor has any other federal or state court in Pennsylvania." As a result, the court granted the insurers' motion to dismiss. The court also dropped a footnote stating that no cause of action existed for the insured's breach of fiduciary duty claim, because it was subsumed under the statutory and contractual bad faith claims that had been brought.

**5) *Gideon v. Nationwide Mutual Fire Insurance Company*, 2008 WL768724 (W.D. Pa. 2008). If an insurer agrees to defense of its insured under a full reservation of rights and then files a declaratory judgment action seeking to extinguish its duty to defend and indemnify, the court will treat that as a denial of coverage.**

In *Gideon v. Nationwide Mutual Fire Insurance Company* the plaintiff had filed suit against Nationwide alleging bad faith for its conduct in delaying the settlement of Nationwide's defense and indemnity obligations for an underlying third party liability

lawsuit. Plaintiff had been sued for injuries sustained when plaintiff fired a hand gun at an occupied vehicle. Plaintiff tendered his defense to Nationwide who agreed to defend plaintiff in an underlying action, but under a full reservation of rights. Nationwide then filed a declaratory judgment action seeking to deny its obligations to defend and indemnify plaintiff in the underlying law suit. The declaratory judgment action ultimately went to trial and was resolved in favor of the plaintiff. Defendant then settled the underlying lawsuit.

Nationwide filed a Motion to Dismiss in the bad faith case claiming that its conduct could not constitute bad faith because it had ultimately defended and indemnified plaintiff.

The Court however concluded that if an insurer provides a defense, reserves its rights and files a declaratory judgment action that this conduct constitutes a denial of an insured's claim. Therefore, if the insurer's actions were done in bad faith the insured can sue for breach of contract and the Court predicted that the Pennsylvania Supreme Court would find that such actions could constitute sufficient allegations to establish a § 8371 bad faith claim against the insurer.

Although this opinion is in direct conflict with *Daniel P. Fuss Builders-Contractors, Inc. v. Assurance Company of America* 2006 WL2372226, the court simply disagreed with the analysis of the issue by that court.

**4) *DeWalt v. Ohio Casualty Co.*, 513 F. Supp. 2d 287 (E.D. Pa. 2007) (McLaughlin, J.). Court holds that the Terletsky standard applies to third-party bad faith claims; negligence standard applies to contractual bad faith claims; in appropriate circumstances, an insurer who delays in accepting a settlement offer, but never actually refuses to settle, may be liable for bad faith.**

In *DeWalt v. Ohio Casualty Co.*, the plaintiff was seriously injured as a passenger in a vehicle driven by an Ohio Casualty insured (as were several other passengers). Ohio Casualty first tendered its single person policy limit of \$25,000 to plaintiff approximately 14 months after the accident (and a year after first being approached about the insurer's "position" concerning a settlement for policy limits). Instead of accepting the carrier's offer, the plaintiff filed suit against the insured and ultimately obtained a \$4 million verdict. The insured then settled with the plaintiff and assigned him any claims that she had against Ohio Casualty. The plaintiff thereafter brought a breach of contract and bad faith action against Ohio Casualty.

One issue before the court was the appropriate standard of liability for both contract based bad faith and statutory bad faith claims. The plaintiff argued that his statutory bad faith claim was governed by *Terletsky* and that his contract claim was governed by a negligence standard. The court agreed. With regard to the statutory bad faith claim, the court noted that several decisions have applied the *Terletsky* standard to third party bad faith claims. *Id.* at 294 (citing *Shubert v. American Independent Ins. Co.*, 2003 U.S. Dist. LEXIS 10769 (E.D. Pa. June 24, 2003 and *Adamski v. Allstate Ins. Co.*, 738 A.2d 1033, 1036 (Pa. Super. Ct. 1999)). Based on this, the court found that the two-part test set forth in *Terletsky* applied to both first and third party bad faith claims under § 8371.

Turning to the contract-based bad faith claim, the court observed that while Pennsylvania law was unclear as to which standard should apply, *Terletsky* was not the appropriate standard for contractual bad faith claims. *Id.* at 295. The court explained that "[n]either the Pennsylvania state courts nor the courts of this circuit have set out an

explicit definition of 'bad faith' for contract actions based on *Cowden [v. Aetna]*, 134 A.2d 223 (Pa. 1957)] or articulated the elements for such claims." *Id.* Under *Cowden*, "[for an insurer to have acted in good faith in refusing to settle, the chance of a finding of non-liability must be real and substantial and the decision to litigate must be made honestly. This means that the sincerity of an insurer's belief is not sufficient to defeat a bad faith claim." *Id.* at 296. Based on case precedent in the Third Circuit, Judge McLaughlin held "that the controlling interpretation of *Cowden* in this circuit is that a contract claim for bad faith requires evidence that an insurer acted negligently or unreasonably in handling the potential settlement of claims against its insured." *Id.* at 297.

After determining the appropriate standards to apply to the statutory and contractual bad faith claims, the court then addressed whether an insurer could be held liable for an excess verdict in a situation where there insurer did not refuse to settle, but had merely delayed in offering the policy's single person limits (which the claimant, at that point, decided not to accept). As a general matter, the Court stated:

Nothing in Pennsylvania law suggests that an insurer must refuse to settle a claim before it can be found to have acted in bad faith. Although most Pennsylvania cases finding bad faith do so in situations where an insurer refuses to settle, no case suggests that such a refusal is a pre-requisite for a bad faith claim. To the contrary, at least one case applying Pennsylvania law has held that, in appropriate circumstances, an insurer who delays in accepting a settlement offer, but never refuses to settle, may nonetheless be liable for bad faith.

*Id.* at 297-98 (citing *Schubert v. American Independent Ins. Co.*, 2003 U.S. Dist. LEXIS 10769, \* 1(E.D. Pa. June 24, 2003)). Applying this standard to the facts before it, the court concluded that the carrier in this case did not act in bad faith by delaying tender of the policy's single person limits. Specifically, the court determined that a letter sent by plaintiff's counsel to Ohio Casualty demanding to know the policy limits and the insurer's

position in tendering those limits to avoid a bad faith claim was not a demand letter. In addition, the court noted that there were several issues (including the nature of the policy and the number of potential claimants) that made it unreasonable for the insurer to immediately make a limits offer to the plaintiff. The insurer could not reduce the amount available for the other claimants without first obtaining sufficient information to fully evaluate their claims. For this reason, the court held that the insurer did not act in bad faith in delaying its offer to the plaintiff.

C. **Exploring Related Causes of Action**

1) ***Simon v. UnumProvident Corp.*, No. 99-6638, 2002 U.S. Dist. LEXIS 9331 (E.D.Pa. May 23, 2002) (Hutton, J.): Insurer may be liable for bad faith and violation of the Unfair Trade Practices and Consumer Protection Law for influencing experts' reports.**

In *Simon v. UnumProvident Corp.*, the plaintiff alleged that the insurer acted in bad faith and violated the Unfair Trade Practices and Consumer Protection Law ("UTPCPL") when it denied his claim for benefits under an occupation specific disability income policy. He filed the claim after being hospitalized for severe anxiety and depression. The insurer moved for summary judgment and based its denial of the claim on the reports of both a psychologist and a psychiatrist.

The plaintiff rebutted this argument by producing evidence that the psychologist initially reported that the plaintiff was "totally and permanently impaired from functioning as a trader on the options floor." The psychologist, however, removed this conclusion from his report after an employee of the insurer telephoned him and claimed that, "there was a problem in his mind with the language of the report." Specifically, the employee maintained that the report's language was "confusing."

The plaintiff also produced evidence that, although the policy defined the

plaintiffs occupation as "options floor trader," the insurer informed the psychiatrist that "options traders' duties are not specific to the floor," and traders "can trade in other areas such as computerized trading." As result of these exchanges, the psychiatrist's report ultimately stated that the plaintiff was able to work "as a trader." In light of this evidence of the insurer's communications with the psychiatrist, the court denied the insurer's motion for summary judgment. In addition, it held that a jury could find that the insurer acted in bad faith during its investigation of the plaintiff's claim and its dealings with the independent medical experts, and further found that the insurer's conduct potentially constituted "malfeasance" for purposes of the UTPCPL claim.

**2) *Tammaro v. Nationwide Ins. Co.*, No. 99-05135 (C.P. Chester, Nov 2, 2001) (Sanchez, J.): Insurer's failure to comply with guarantees in insurance policy may support claim under Unfair Trade Practices and Consumer Protection Law.**

In *Tammaro v. Nationwide Insurance Co.*, the plaintiff filed a complaint containing counts for bad faith, pursuant to 42 Pa. C.S.A. §837 1, and violation of the Unfair Trade Practices and Consumer Protection Law ("UTPCPL"). The plaintiff's allegations stemmed from the insurer's handling of his UIM claim. The insurer moved for summary judgment, arguing, inter alia, that §8371 bars a cause of action under the UTPCPL. The court disagreed, holding that §8371 does not bar causes of action for fraud and deceit under the UTPCPL. In reaching this decision, the court noted that the insurer's policy contained written guarantees that: 1) "Nationwide is on your side"; and 2) Nationwide will "jointly determine with the insured" liability and damages when a loss occurs due to an uninsured motorist. The court concluded that a genuine issue of material fact existed as to whether Nationwide failed to comply with these stated guarantees in violation of 73 Pa. C.S. §201-2(4)(xiv) and (xxi).

**3) *Dilworth v. Metropolitan Life Ins. Co.*, 418 F.3d 345 (3d Cir. 2005)  
(Greenberg, J.): Insured's failure to read policy did not preclude application of discovery rule or finding of justifiable reliance in "vanishing premiums" case.**

In *Dilworth v. Metropolitan Life Insurance Co.*, the plaintiff brought claims for negligence, fraud, and violation of the Unfair Trade Practices and Consumer Protection Law ("UTPCPL"). The plaintiff based these claims on her insurer's oral representations, through its agent, that her life insurance policy would yield sufficient dividends, cash value and interest to cover the premiums after ten years.

The district court entered summary judgment for the insurer on all three claims, holding that the plaintiff's failure to read her policy precluded (1) application of the discovery rule to the tort claims, and (2) precluded a finding of justifiable reliance in the UTPCPL claim. The Court of Appeals reversed, noting that the Pennsylvania Supreme Court has never held that an insured must inspect her policy to obtain the benefit of the discovery rule. Such a requirement, the court reasoned, would be at odds with the doctrine of reasonable expectations. The court next observed that, even if the plaintiff had read her policy, this would not have put her on notice of the agent's misrepresentations; specifically, the policy merely stated the number of premium payments without specifying the source of those payments. The court thus concluded that the discovery rule applied and the plaintiff's tort claims were not barred.

Turning next to the UTPCPL claim, the court held that Pennsylvania law does not allow an insurer to use the explicit language of its insurance policy to defeat the reasonable expectations of an insured. Furthermore, it is not unreasonable for an insured to rely on the representations of the insurer's agent rather than the contents of the policy to understand either cost of her policy or the scope of coverage. Thus, the court

concluded, an issue of fact precluding summary judgment existed on the element of justifiable reliance.

**4) *Cronin v. State Farm Mutual Auto. Ins. Co.*, 2006 U.S. Dist. LEXIS 82139 (M.D. Pa. Oct. 30, 2006) (Caputo, J): Motor Vehicle Financial Responsibility Law preempts bad faith statute, therefore a plaintiff cannot bring a claim under the Pennsylvania Bad Faith Statute for an insurer's refusal to pay medical benefits incurred in connection with a motor vehicle accident.**

*Cronin v. State Farm Mutual Automobile Insurance Co.* involved a claim arising from the insurer's refusal to pay medical and wage loss benefits arising from the plaintiff's injury in a motor vehicle accident. The plaintiff subsequently brought suit under 42 Pa. C.S.A. §837 1. In response, the insurer moved to dismiss the bad faith claim to the extent that it related to its refusal to pay medical benefits. The court agreed, reasoning that the bad faith statute conflicted with and was ultimately preempted by the Motor Vehicle Financial Responsibility Law ("MVFRL"), noting that while the statutes punish similar conduct, they provide disparate remedies (the MVFRL entitles the insured to 12% interest, while the bad faith statute only provides for an award of 3% interest). As the statutes were irreconcilable, the court concluded that the specific provisions of the MVFRL trumped the general bad faith statute. Accordingly, the court granted the defendant's motion to dismiss the plaintiff's bad faith claim to the extent that it related to medical benefits.

**5) *Johnson v. Northland Ins. Co.*, No. 2:05cv 927 2005 U.S. Dist. LEXIS 35102 (W.D. Pa. Dec. 21, 2005): No separate claim for breach of fiduciary duty where the claim is redundant of bad faith and breach of contract claims.**

In *Johnson v. Northland Ins. Co.*, the court dismissed the insured's breach of fiduciary duty claim against her insurer. There, the insured alleged that she had suffered physical injuries while she was a passenger in a limousine insured by Northland

Insurance Company. Northland declined to pay the insured's medical bills or provide compensation for lost wages, contending that her symptoms were not related to the accident. As a result, the insured filed a complaint against Northland, alleging counts for breach of contract, bad faith pursuant to 42 Pa. C.S.A. § 8371, and breach of fiduciary duty. To support the breach of fiduciary duty claim, the insured alleged that Northland had failed to act in a reasonable matter in processing her claims for firstparty benefits. The Court granted Northland's motion to dismiss in part. In dismissing the breach of fiduciary duty count, the court noted that "[t]here is considerable case law to support [Northland's] position that the [breach of fiduciary claim] is not a separate claim, but rather is subsumed in the bad faith and breach of contract claims." *Id.* at \*15. Further, the court observed that an insurer generally does not owe a fiduciary duty to its insured, except in limited circumstances such as where the insurer asserts a right to defend claims against the insured. Ultimately, the court determined that the insured's claim for breach of fiduciary duty was redundant of her bad faith and breach of contract claims and, in any event, did not involve one of the limited circumstances supporting a claim for breach of fiduciary duty. *Id.* at \*15-16.

6) ***Toy v. Metropolitan Life Insurance Co.*, 928 A.2d 186 (Pa. 2007): “Bad faith” under Pa. C.S. § 8371, does not provide a remedy for unfair or deceptive practices in soliciting the purchase of a policy.**

In *Toy v. Metropolitan Life Insurance Co.*, the Pennsylvania Supreme Court considered the proper scope of Pennsylvania's bad faith statute. The insured's suit alleged that Metropolitan Life created a marketing scheme which misrepresented the Policy as a savings or investment vehicle and that due to the insurer's misrepresentations she purchased life insurance she did not want. Based on these allegations, the insured made a claim against Metropolitan Life pursuant to Pennsylvania's bad faith statute (as

well as under the Consumer Protection Law and for fraud, negligent misrepresentation, and negligent supervision). The trial court granted Metropolitan Life's motion for summary judgment on the bad faith claim (and, indeed, on all counts), and the Superior Court affirmed the trial court's ruling on bad faith (on different grounds).

Writing for the Court, Chief Justice Cappy -- joined by Justices Castille and Saylor (Justices Newman and Baldwin did not participate in the decision) -- affirmed the Superior Court's decision (again on different grounds), holding that a bad faith claim may not be premised on allegations that an insurer engaged in deceptive or unfair conduct in soliciting the insured to purchase an insurance policy. The insured argued that the bad faith statute was intended to remedy any act that is prohibited to insurers under Pennsylvania's common or statutory law. In rejecting this broad reading of the statute, the Majority noted that the issue was a matter of statutory construction. As such, the Majority observed that when the General Assembly enacted § 8371, "the term 'bad faith' had acquired a 'peculiar and appropriate meaning'" in the insurance context. *Id.* at 195 (quoting 1 Pa.C.S. § 1903). The Majority explained that "peculiar and appropriate meaning" as follows:

[T]he term "bad faith" concerned the duty of good faith and fair dealing in the parties' contract and the manner by which an insurer discharged its obligations of defense and indemnification in the third-party claim context or its obligation to pay for a loss in the first party claim context. In other words, **the term captured those actions an insurer took when called upon to perform its contractual obligations of defense and indemnification or payment of a loss that failed to satisfy the duty of good faith and fair dealing implied in the parties insurance contract.**

*Id.* at 199 (emphasis added). Thus, the Majority concluded, when § 8371, "is read with

this meaning of bad faith in mind, we can only conclude on the question before us, that the words of the statute are clear and explicit, and that the Legislature intended not to give relief under the bad faith statute to an insured who alleges that his insurer engaged in unfair or deceptive practices in soliciting the purchase [of] a policy." *Id.* at 200.

While the Toy Court's holding concerning the limited scope of Section 8371 was, itself, a pivotal ruling, the *Toy* opinion is almost as important with respect to those issues which the Court flagged but left open for another day. For example, in a rather long footnote to the opinion, the Majority noted in dicta that Toy's assertion that the Superior Court has "repeatedly held that allegations of UIPA violations constitute a claim of bad faith under §8371" has "no merit." *Id.* at 200 n. 17. The Supreme Court clarified that the cases *Toy* cited for its position concern "two questions raised by the bad faith statute with which the lower courts have been grappling, but which are not before us and remain for another day." *Id.* The first involves the role that the UIPA may play in the trial of a bad faith claim (*i.e.*, whether the insured can introduce evidence of violations of the UIPA as evidence of bad faith under Section 8371) and the second concerns "whether an insurer's conduct in litigating the bad faith claim that its insured asserts against it in a complaint may be considered by the court in determining whether and to what extent an insured is entitled to relief under §837 1." *Id.*

Additionally, the Supreme Court took no position on the Superior Court's reiteration of the *Terletsky* two-pronged standard as the appropriate standard to be applied in determining whether an insurer is liable under Section 8371 and stated that it would likewise take no position on whether Section 8371 "creates an independent cause of action or is a form of additional relief under a cause of action. *See Birth Center v. St.*

*Paul Companies*, 567 Pa. 386, 787 A.2d 376, 387 n.14 (Pa. 2001)."

**D. What to Consider When Figuring Damages**

**1) Willow Inn v. Public Service Mut. Ins. Co., 2005 WL 334200 (3d Cir. Feb. 14, 2005) (Smith, J.): Attorneys' fees and costs awarded pursuant to § 8371 are compensatory damages for purposes of Gore/Campbell ratio.**

In *Willow Inn v. Public Service Mutual Ins. Co.*, the plaintiff alleged that the insurer breached a commercial property insurance policy and handled the plaintiffs' claim in bad faith when it (1) delayed payment of a \$125,000 claim for more than eight months, and (2) refused to pay the plaintiff's \$2,000 cost to prepare proofs of loss, which cost was specifically covered under the policy. The district court returned a bench trial verdict for the plaintiff, awarding the plaintiff \$2,000 for the breach of contract claim, \$150,000 in punitive damages, and attorneys fees and costs totaling \$135,000. The Court of Appeals for the Third Circuit, however, vacated and remanded the punitive damages award with instructions to apply the guideposts set forth in *BMW v. Gore*, 517 U.S. 599 (1996) and *Campbell v. State Farm*, 538 U.S. 408 (2003).

On remand, the district court held that the \$150,000 punitive award was not constitutionally excessive. Applying the Gore/Campbell guideposts, the district court found that the insurer's behavior was reprehensible in light of the plaintiff's financial vulnerability. The court also considered insurer's repeated misconduct, and the unreasonable delay in payment. Additionally, the district court also concluded that the ratio of the punitive award to the compensatory damages was not disproportionate. The ratio was roughly 1:1 because the punitive award was approximately equal to the plaintiff's claim under the policy. Finally, the district court held that the punitive

damages award was comparable to civil penalties that could be imposed, because the award of attorneys fees and costs was approximately equal to the punitive award.

The defendants appealed the district court's opinion a second time, but on this occasion, the Third Circuit affirmed the award after performing its own analysis under the Gore/Campbell guideposts. The Third Circuit agreed with the district court's findings concerning the degree of reprehensibility of the defendant's conduct, noting that the district court was in the best position to assess this factor. Regarding the ratio of the punitive award to the compensatory damages, the Third Circuit held that neither the underlying claim for \$125,000 nor the compensatory award of \$2,000 was the proper figure with which to compare the punitive award. Instead, the attorneys' fees and costs awarded under §8371 was the appropriate yardstick. Any other conclusion would render §8371 useless where the underlying claim had been settled and paid.

Turning next to the disparity between the punitive award and civil penalties, the court held that attorneys' fees and costs should not be considered civil penalties. The most comparable civil penalties, the court held, were contained in the Unfair Insurance Practices Act, and included fines of \$5,000. The Act also provided for escalating penalties in the event of repeat violations, up to and including suspension and revocation of one's license to issue insurance policies. The court noted that it was unsure how to apply this guidepost, because the Supreme Court has never declared how punitive awards are to be measured against civil penalties.

**2) *Jurinko v. Medical Protective Company*, 2006 U.S. Dist. LEXIS 42923 (E.D. Pa. June 23, 2006) (Rufe, J): (1) Punitive damages award was not unconstitutionally excessive where ratio of punitive damages to compensatory damages was 3.77:1; and (2) the lodestar approach, and not percentage-of-recovery method, is appropriate method to use when considering an award of attorneys' fees in § 8371 bad faith claim.**

The claim at issue in *Jurinko v. Medical Protective Company* arose in connection with an underlying medical malpractice suit between the plaintiffs and the defendant's insured, a dermatologist. The defendant refused to tender its policy limits to settle the malpractice suit and, according to the plaintiffs, hired an attorney whose conflict of interest prevented him from vigorously defending the insured. The malpractice case went to trial, and a \$2.5 million verdict was entered in favor of the plaintiffs (which was \$1.5 million in excess of policy limits). In lieu of paying the excess verdict with personal assets, the insured assigned his right to pursue the bad faith claim to the plaintiffs. The plaintiffs were successful in this claim and received an award in the amount of \$7,908,345.

Following the verdict, the plaintiffs filed a motion to mold the verdict to include an award for attorneys' fees, and the defendant filed a motion for reconsideration. Regarding the reconsideration motion, the defendant argued that the court misapplied the Supreme Court's test as set forth in *State Farm v. Campbell* when it held that "all punitive damages with a ratio of damages to harm of four to one are constitutionally permissible." The court rejected this argument, stating that it acknowledged that *State Farm* declined to impose a bright line ratio which a punitive damages award cannot exceed. Nevertheless, in *State Farm*, the Court noted that "an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety[.]" especially when the compensatory damages are substantial. In light of this reasoning, the court concluded that a ratio of 3.77:1 was not unconstitutionally excessive and, accordingly, denied the defendant's motion for reconsideration.

Turning next to the plaintiffs' motion to mold the verdict, the court rejected the

defendant's argument that the plaintiffs were made whole by the punitive damages award and, therefore, should not receive attorneys' fees. The court reasoned that attorneys' fees serve to compensate a victorious plaintiff, as opposed to punishing a losing defendant. As a result, the court found that the plaintiffs were entitled to attorney's fees. This being said, the court declined to adopt the percentage-of-recovery method proposed by the plaintiffs when considering the reasonableness of the requested amount. The plaintiffs argued that this method was appropriate because bad faith cases, as a class, are uniformly handled on a contingency fee basis. The court, however, pointed out that Rule 1716 governs determinations of fees in cases arising under §8371. Birth Center made clear that application of this rule begins with the use of the lodestar method. As for the plaintiffs' claim that the percentage-of-recovery method most accurately reflects the handling of bad faith cases as a class, the court cited the Third Circuit's ruling in *Poselli v. Nationwide Mutual Insurance*, 126 F.3d 534 (3d. Cir. 1997) for the proposition that the Pennsylvania Supreme Court "would reject the use of contingency enhancements that reflect the risk of contingency cases as a class." Based on this reasoning, the district court applied the lodestar method, and not the percentage-of-recovery method, when determining attorneys' fees.

**3) *Hollock v. Erie Insurance Exchange*, 842 A.2d 409 (Pa.Super. Jan 22, 2004), appeal granted in part, 878 A.2d 864 (Pa. June 28,2005), appeal dismissed as improvidently granted, 903 A.2d 1185 (Pa. Aug. 22, 2006) (dissenting statement by Justice Cappy, in which Justice Castille joined.**

In *Hollock v. Erie Insurance Exchange*, 842 A.2d 409 (Pa.Super. Jan 22, 2004), the plaintiff alleged that the insurer had handled her UIM claim in bad faith. The trial court, sitting without a jury, found that the insurer had acted in bad faith in numerous ways, and awarded \$2.8 million in punitive damages, as well as \$278,825 in attorneys

fees.

The Superior Court en banc affirmed, holding, *inter alia*, that the insurer's conduct during litigation could constitute bad faith under *O'Donnell v. Allstate*, 734 A.2d 901 (Pa. Super. 1999), because that conduct exceeded mere discovery matters and was an intentional attempt to conceal, hide, or otherwise cover up the conduct of Erie employees. The court rejected the insurer's argument, based on *Ridgeway v. United State Life*, 793 A.2d 972 (Pa. Super. 2002), that because the insurer had paid the claim before the bad faith case was filed, its conduct during that litigation could not be considered.

The court further held that the testimony of Erie's witnesses did not establish a reasonable basis as a matter of law, because the trial court was not required to accept the veracity of that testimony. The court distinguished the facts of *Hollock* from those of *Terletsky v. Prudential*, 649 A.2d 680 (Pa. Super. 1994), noting that there was no unsettled point of law in *Hollock* to preclude a finding of bad faith. The court held that the trial court acted well within its discretion in finding that the plaintiff had established bad faith by clear and convincing evidence.

On the issue of punitive damages, the court held that a finding of bad faith is the only prerequisite to a punitive damages award under §8371, because the elements of proof necessary to establish a claim for punitive damages under the statute are coextensive with those that establish the bad faith claim itself. Proof of bad faith thus allows, but does not compel, an award of punitive damages. On the amount of the award, the court first addressed the factors considered under Pennsylvania law: the character of the act; the nature and extent of the harm; and the wealth of the defendant. Finding no abuse of discretion in view of these factors, the court proceeded to review the award

under the factors set forth in *State Farm v. Campbell*, 123 S. Ct. 1513 (2003): the degree of reprehensibility of the defendant's misconduct; the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and the difference between the punitive damages awarded and the civil penalties authorized or imposed in similar cases. These factors, the court held, also supported the award.

The court noted that the compensatory damages consisted only of attorneys' fees, costs, and interest, but where the compensatory award is small in spite of the defendant's egregious conduct, it may be appropriate to award a larger amount of punitive damages. The court also observed that the punitive damages represented a 10 to 1 ratio over the compensatory award, which barely exceeded the single digit ratio referred to in *Campbell*, and, in view of these factors, upheld the award.

On June 28, 2005, the Pennsylvania Supreme Court granted in part Erie's petition for allowance of appeal, limited to the following issues:

- 1) Whether conduct of a party during a bad faith action under 42 Pa.C.S. §8371 is admissible to support a finding of punitive damages.
- 2) What scope of review should an appellate court apply when reviewing a punitive damage award.

On August 22, 2006, the Court issued a *per curiam* order dismissing the appeal as improvidently granted (with a dissenting statement filed by Chief Justice Cappy and joined by Justice Castille).

