

Minimizing Bad Faith Insurance Risks in First-Party Property Claims

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Bad Faith in First-Party Property Claims

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Types of bad faith claims that generally arise in the context of first-party property claims

Bad faith standards generally (lacking a reasonable basis / fairly debatable)

Allegations of bad faith related to:

- Business practices/company-wide refusals to pay certain benefits:
 - Overhead & profit
 - Depreciation of labor
- Refusal to complete a reasonable investigation
- Refusal to complete or participate in Appraisal process
- Use and reliance on biased “experts,” including origin/cause, and adjusters
- Defamation (slander/libel)
- Unreasonable delay in handling
- Social duty/Failure to warn of known danger

CASE LAW

Bad Faith in the Property Insurance Context



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CASE LAW

Introduction

- Bad faith in property insurance context pertains to a **first party claim**, *i.e.*, insured's claim against his/her/its property insurer, typically claiming insurer unreasonably failed to settle claim in good faith
- Although essence of bad faith claims is generally the same, each jurisdiction has its own nuanced twist as to what constitutes an insurer engaging in bad faith (but jurisdictions recognize such claims exist: statutory or common law) - burden of proof and remedies different from state to state
- Oftentimes, bad faith is a QUESTION OF FACT since it is based on the actual facts / conduct of insurer that insured claims amounts to bad faith
- Types of damages= value of claim, consequential damages, punitive damages, attorney's fees and costs, etc.

CASE LAW

Florida



- In FL bad faith action is **PREMATURE** prior to **determination of coverage** and **extent of insured's covered loss**
- FL has statute (Fla. Stat. s. 624.155) that requires Civil Remedy Notice (CRN) as a **CONDITION PRECEDENT** to insured initiating bad faith action (lists statutory violations)

CASE LAW

Florida



Barton v. Capitol Preferred Insurance Co., Inc., 208 So.3d 289 (Fla. 5th DCA)

- Insured sued property insurer for sinkhole coverage
- Insured filed CRN with FL Dept. of Insur.
- During coverage suit, insured served proposal for settlement / offer of judgment that was less insured's original demand. Insured accepted and paid proposal/offer.
- Insured's proposal/offer did not require it to release insurer for bad faith and insured sued insurer for bad faith
- **“An insured can obtain a determination of liability through an agreed settlement, arbitration or stipulation—the determination of liability / coverage does not have to be made through trial.”**
- The insurer accepting and paying proposal/offer was determination of liability, satisfying condition precedent to bad faith claim
- Bad faith claim can arise even if determination is less than insured's original demand or policy limits

CASE LAW

Florida



Fox v. Starr Indemnity & Liability Co., 2017 WL 1541294 (M.D.Fla. 2017)

- Insured sued property insurer for bad faith
- Insurer argued that Insured's CRN was deficient (meaning insured didn't properly satisfy condition precedent) because it deficiently listed the insurer's statutory violations
- Court held that **substantial compliance** filling out CRN is sufficient--Court wasn't going to dismiss bad faith claim based on technicality with how CRN drafted when insured substantially complied with intent of putting insurer on notice of violations giving rise to the bad faith claim

CASE LAW

Florida



Landers v. State Farm Florida Ins. Co., 2017 WL 3443077 (Fla. 5th DCA 2017) (unpublished)

- Insured dispute with insurer re: repair protocol since repairs exceeded policy limits
- Insured filed CRN prior to appraisal process – insured claimed insurer was delaying paying policy limits and low-balling repairs and costs
- Appraisal process found repairs exceeded insured's policy limits and insurer tendered policy limits
- Insured sued insurer in bad faith claiming repairs always exceeded policy limits and insurer engaged in bad faith by delaying payment until conclusion of appraisal process
- **Court held that insured under a property insurance policy can file a CRN BEFORE appraisal process is complete**
- **Court held appraisal process satisfies condition precedent: 1) determination re: insurer's liability for coverage and 2) determination re: extent of insured's damages**

CASE LAW INDIANA



Backwater, Inc. v. Penn-American Ins. Co., 448 F.3d 962 (7th Cir. 2006)

- Insured's nightclub vandalized resulting in extensive damage
- Insured filed claim with property insurer which rejected claim claiming investigation revealed inside job
- **“Insurer breaches its obligation to deal fairly with an insured when it denies a claim knowing there is no rational, principled basis for doing so.”**
- **Rational basis**: Insured increased coverage by \$600,000 fewer than 60 days before vandalism; insured then made dubious calls to alarm company; vandalism was unusually thorough in that security system was disabled and insured's principal installed system, and insured was losing money and had run-ins with community re: nightclub

CASE LAW OKLAHOMA



Hayes Family Trust v. State Farm Fire and Casualty Co., 688 Fed.Appx. 551 (10th Cir. 2017) (unpublished)

- Insured filed property insurance claim due to storm damage
- Insured and insurer could not agree on amount of loss and insured demanded appraisal
- Insurer rejected appraisal claiming since dispute concerned coverage issue
- Insured filed suit for appraisal and insurer later paid full amount of loss
- Insured also sued for bad faith claiming insurer breached duty of good faith and fair dealing by refusing appraisal and failing to adequately investigate
- **“To establish a bad faith claim, ‘the insured must present evidence from which a reasonable jury could conclude that the insurer did not have a good faith belief’ for its conduct. An insurer is entitled to summary judgment on a bad faith claim if it acts in accordance with a legitimate dispute concerning coverage, and the insured fails to produce additional evidence of bad faith to support sending the issue to the jury.”**
- Denying appraisal did not constitute bad faith; insurer’s investigation was adequate as insurer inspected property multiple times and prepared estimates as to amount of covered loss

CASE LAW COLORADO



Home Loan Investment Co. v. St. Paul Mercury Ins. Co., 827 F.3d 1256 (10th Cir. 2006)

- Fire loss damaged home
- Mortgagee that procured policy submitted claim and claim denied; insurer refunded mortgagee's premium payment
- Mortgagee sued insurer and included statutory claim for unreasonable delay and denial of insurance benefits (statutory bad faith)
- Mortgagee prevailed at trial and insurer appealed
- **Insurer's denial of "fairly debatable" claim was not per se reasonable – just because insurer's position was allegedly fairly debatable did not in of itself mean that insurer acted reasonably**
- Bad faith applies whether claim is unreasonably delayed or denied due to claims-handling or underwriting process

CASE LAW

California



Paslay v. State Farm General Ins. Co., 248 Cal.App.4th 639 (2016)

- Insured's house damaged due to heavy rain
- Insurer arranged for insured to live in rented house
- Insurer paid in excess of \$248,000 but denied coverage for certain repair items
- Insured sued which included claim for bad faith
- **Obligation of good faith and fair dealing by insurer but insured must demonstrate that insurer's misconduct is more egregious than incorrect denial of policy benefits**
- **“In the context of a bad faith claim, ‘an insurer’s denial of or delay in paying benefits gives rise to tort damages only if the insured shows the denial or delay was unreasonable.’**
- **Genuine dispute re: extent of damage and required repairs did not constitute bad faith** (insurer's expert inspected home and provided estimate and insured hindered further investigations by removing damaged property)

CASE LAW

Alabama



Adams v. Auto-Owners Ins. Co., 655 So.2d 969 (Ala. 1995)

- Insured submitted claim due to storm / wind damage (resulting in damage to roof and leak)
- Insurer engaged engineer which determined most of roof damage due to old age and only \$2,509.92 due to wind
- Insured engaged consultant that found roof damage due to wind
- Insured sued insurer including claim for bad faith
- **“A plaintiff alleging bad faith must show (1) that there was ‘an insurance contract between the parties’; (2) ‘an intentional refusal to pay the insured’s claims’; (3) the absence of any reasonably legitimate or arguable reason for that refusal’; (4) ‘the insurer’s actual knowledge of the absence of any legitimate or arguable reason’; and (5) ‘if the intentional failure to determine the existence of a lawful basis is relied upon, the plaintiff must prove the insurer’s intentional failure to determine whether there is a legitimate or arguable reason to refuse to pay the claim.’”**
 - **If insurer’s reasoning for denying benefits is arguable, a claim for bad faith will not lie**
- Insurer had reasonably arguable reason for denying coverage so bad faith not apply (insurer acted on independent site investigations indicating damage resulted from old age)

CASE LAW

Pennsylvania



Whalen v. State Farm Fire and Casualty Co., 183 F.Supp.3d 672 (E.D.Penn. 2016)

- Insured's home sustained water damage due to failed supply line in upstairs sink
- Insured and insurer disagreed re: scope of covered loss; insurer requested appraisal but insured did not agree to request
- Bad faith is statutory cause of action. **“[T]o recover under the bad faith statute, a plaintiff must show, by clear and convincing evidence: ‘(1) that the insure lacked a reasonable basis for denying benefits; and (2) that the insurer knew or recklessly disregarded its lack of reasonable basis.’ Merely negligent conduct, however harmful to the interests of the insured, is recognized by Pennsylvania courts to be categorically below the threshold required for a showing of bad faith.”**
- Insurer did not act in bad faith – no clear and convincing evidence that insurer's conduct was unreasonable and it knew or recklessly disregarded its lack of a reasonable basis in denying claim

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Stafford Publications Webinar

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Section III

- Best Practices to minimize risks of bad faith allegations in property claims



What Is Bad Faith?

Common Law or Statutory

- **First-Party Claims:** Failure to pay, unnecessary delay in paying benefits, improper claim handling
 - Generally, insured must show that the insurer lacked a reasonable basis for its coverage position, and that it knew or disregarded that it lacked a reasonable basis

Claim Handling As The Initial Step In Avoiding A Bad Faith Claim

- Prompt acknowledgement of a claim;
- Knowledge of state specific regulations pertaining to claim handling and timing of response to claim;
 - N.Y. Ins. Law 3420(d)(2)
- Review of internal guidelines concerning claim handling;
- Prompt and frequent communication with insured after claim is submitted;
 - Preparation by claims personnel of internal and external communications with the expectation that they will be subject to disclosure
- Being proactive with moving a claim forward, including follow up communications to the insured if requested information is not provided or further investigation is necessary
 - Bad faith claims can arise not just in the context of allegedly wrongful denial of coverage, but for allegedly unnecessary delay in providing coverage

Supporting Your Coverage Position

Acting “reasonable under the circumstances”:

- Conducting a thorough investigation before providing your position;
 - Bad faith typically requires intentional conduct, rather than simply negligence – it is usually not sufficient that the carrier’s coverage position was incorrect, if it acted in good faith
- Retaining an expert and/or independent adjusting service to assist in the claim investigation, as appropriate;
 - Examination of expert’s qualifications;
 - Sharing of all relevant information with expert;
 - Avoid “suggesting” outcome of expert’s analysis
- Meet with the insured and insured’s representatives and solicit documents and information from them;
- Notify insured in writing of any potential coverage issues as soon as possible;
- Timely respond to any “push back” received from insured;
- Fully evaluate all settlement demands
 - Assess settlement demand based on the facts of the case and the applicable law
 - Be aware of “low ball” settlement offers, which may be used as indicia of bad faith
 - Be conscious of coverage limits, and extent to which a settlement of one claim may exhaust coverage for other claims
 - One approach: Seek insured’s consent to settle

Pitfalls To Avoid

- Communications to the insured where the insurer's coverage position is unclear
- Beware of “cutting and pasting” from prior correspondence or correspondence from other claims, no matter how similar
- References to policy forms or endorsements not on the policy
- Citing paragraph after paragraph of policy language without any discussion of how the policy language may apply to the claim
- Engaging in strained construction of policy language