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After 25 Years, Bad-Faith Statute Still Challenging Attorneys

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July 1 marked the quarter-century anniversary of the enactment of Pennsylvania's insurance bad-faith statute, 42 Pa. C.S.A. Section 8371. This landmark legislation permitted policyholders and insureds to directly sue their insurers for bad-faith conduct and, if successful, recover punitive damages, attorney fees, interest and costs. For attorneys who litigate in the insurance field, and the courts before whom they appear, this one-paragraph, 81-word statute spawned legal issues far more numerous than its modest size portended. Each year, it seems, the state and federal courts are called upon to address a new wrinkle wrought by the statute, and the past 12 months or so have proved no exception.

Two interesting recent decisions had their genesis in the same third-party excess verdict case.

Jared Wolfe was injured when his vehicle was struck by an automobile driven by Allstate's insured, Karl Zierle, who was intoxicated. Wolfe demanded Allstate's $25,000 policy limits to settle, Allstate refused, the case went to trial, and Wolfe recovered a verdict against Zierle for $15,000 in compensatory damages and $50,000 in punitive damages. Allstate paid the compensatory judgment only. Zierle executed an assignment to Wolfe, who sued Allstate for bad faith. Allstate removed the bad-faith action to federal court. A federal jury found bad faith and awarded Wolfe $50,000 in punitive damages, under Section 8371.

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When the case reached the U.S. Court of Appeals for the Third Circuit, the court asked the Pennsylvania Supreme Court to resolve the question of whether a claim under Section 8371 could be assigned by the insured under the circumstances presented. Over the years, the courts had come down on both sides of the issue, with some courts finding that to allow assignment of a Section 8371 claim would be tantamount to allowing champerty. In *Allstate v. Wolfe*, 105 A.3d 1181 (Pa. 2014), the Supreme Court decided the issue. Noting that Pennsylvania had long permitted assignment of common-law bad-faith claims, the court ruled in favor of allowing the assignment of a Section 8371 bad-faith claim.

In the subsequent decision in *Allstate v. Wolfe*, 2015 U.S. App. LEXIS 9876 (3d Cir. June 12, 2015), the Third Circuit reversed the verdict against Allstate. The court held that the district court should have granted the insurer's pretrial motion to exclude evidence of the underlying punitive award as "a logical extension of Pennsylvania's policy regarding the uninsurability of punitive damages." According to the court, "an insurer has no duty to consider the potential for the jury to return a verdict for punitive damages when it is negotiating a settlement of the case."

The court concluded that because the underlying punitive award could not provide the basis for an award in the bad-faith case, it was not relevant to the issues at trial—either to the statutory bad-faith claim or to the common-law bad-faith claim for failure to settle the third-party action also brought by the insured. Despite ruling that the insured could not recover the underlying punitive award as compensatory damages, the Third Circuit remanded the case for retrial on the bad-faith claim, observing that the insured could still recover nominal damages in a common-law claim, and that in the

Section 8371 claim, the focus would be on the insurer's conduct, not the insured's damages.

Mohney v. American General Life Insurance, 2015 PA Super 113 (Pa. Super. May 8, 2015), is another recent case of note. The Superior Court reversed a bad-faith verdict in favor of a disability insurer that was rendered in a bench trial in Armstrong County. After the insured was injured in an accident, the insurer initially paid benefits under the applicable disability policy, but later stopped payments after a treating physician indicated in response to a questionnaire that it was possible the insured could perform three specific jobs—adding that the insured would have to try the jobs first to see if he actually could perform them.

In finding against the insurer, the Superior Court reaffirmed the two-pronged framework for bad faith set down over 20 years ago in *Terletsky v. Prudential Property and Casualty Insurance*, 649 A.2d 680 (Pa. Super.1994): To establish bad faith, the insured must prove by clear and convincing evidence that the insurer had no reasonable basis for its claims denial, and the insurer knew or recklessly disregarded the fact that it had no reasonable basis. The Superior Court held that the trial court erred in its application of both parts of the test. Contrary to the trial court's finding, the appellate court ruled that there was no reasonable basis for the insurer's reliance upon the questionnaire sent to the treating physician which did not establish that the insured could indeed work in the jobs described. The trial court's error on that point, according to the Superior Court, "substantially impacted its subsequent ruling that [the insurer] did not knowingly or recklessly disregard its lack of a reasonable basis."

Bad-faith claims arising out of uninsured and underinsured motorist claims continue to keep the courts and practitioners busy. Most auto insurers removed mandatory arbitration clauses from their policies following the Supreme Court decision in *Insurance Federation of Pennsylvania v. Koken*, 889 A.2d 550 (Pa. 2005). One significant issue arising in Koken's wake was whether a UM/UIM claim against the insurer should proceed simultaneously with a bad-faith claim, or whether such claims will be bifurcated or severed. The trend in the state courts has been less pronounced than that in the federal courts. The state courts appear more willing to consider bifurcation, noting the impact on discovery if bifurcation is not granted. The federal courts are much less likely to bifurcate the claims.

In an illustrative case, *Hoffer v. Grange Insurance*, 2014 U.S. Dist. LEXIS 137078 (M.D. Pa. Sept. 29, 2014), the U.S. District Court for the Middle District of Pennsylvania focused on the similarity of the accident and injury-related portions of the case, rather than on the differences between the proofs relating to those aspects and those relating to actual proof of bad faith, and discounted any prejudice to the insurer. By contrast, in *Dunkelberger v. Erie Insurance*, 21 Pa. D. & C.5th 52 (Lebanon 2011), the court placed greater weight on the prejudice to the insurer in being forced to disclose its work product in the context of the UIM case, explaining that such disclosures were akin to giving the other team a playbook before the game.

Privilege and work product continue to be the most prominent issues regarding bifurcation and severance, as illustrated in a recent UM case, *Lane v. State Farm Mutual Automobile Insurance*, 2015 U.S. Dist. LEXIS 64679 (M.D. Pa. May 18, 2015). The court there addressed the discoverability of documents implicating prelitigation work product as well as post-litigation attorney-client communications. The court held that both the work-product doctrine and attorney-client privilege were applicable in bad-faith cases, and that bad-faith allegations did not undermine those protections. The court also emphasized that it was important for insureds to set forth a nexus between post-complaint evidence and bad-faith conduct in order to show the court that such information was relevant, an inquiry that will vary from case to case.

Last year produced an eye-popping nonjury verdict in *Berg v. Nationwide Mutual Insurance*, C.A. No. 98-813 (Berks Co. May 28, 2015), a case arising out of a property damage claim under a personal auto policy. The Berks County Court of Common Pleas awarded the plaintiff insureds $18 million in punitive damages and $3 million in attorney fees and costs under Section 8371. The insurer's post-trial motions have been denied, and Nationwide has filed an appeal to the Superior Court.

The appellate court in *Berg* has been asked to weigh in on several significant issues, including: (1) whether an attorney fee award can be included as part of the calculation on which a constitutionally permissible punitive damage award can be based; (2) whether prejudgment interest is awarded just on the underlying claim or also on the bad-faith verdict; and (3) whether post-claim conduct by the insurer or its counsel in the bad-faith litigation can be used to prove liability in the Section 8371 claim.

In its unpredictable twists and turns—the lawsuit was commenced in 1998, and has involved multiple appeals, still continuing—the *Berg* case reflects the evolution of the bad-faith statute itself. Over the past 25 years, Section 8371 has taken attorneys, their interested clients, and state and federal judges on a jurisprudential journey that few likely imagined when those 81 words were inserted with little fanfare into the insurance law books. As with the *Berg* case, that journey continues. New issues will continue to crop up, and a new generation of attorneys and jurists will continue to grapple with the scope and effect of Pennsylvania's bad-faith statute.