

ALERT

No Bad Faith Where Insurer's Actions Were Reasonable

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The United States District Court for the Western District of Pennsylvania, applying Pennsylvania law, has held that an insurer did not act in bad faith by denying coverage due to insured's failure to give notice of circumstances likely to lead to a claim, but that issues of fact precluded summary judgment as to coverage. *Foster v. Westchester Fire Ins. Co.*, WL 4382971 (W.D. Pa. Sept. 20, 2011)

The policyholder, an attorney, was sued for malpractice by an executrix and former client after a court found that a power of attorney created by the policyholder was faulty. The policyholder drafted the power of attorney in May 1995. In September 2000 the policyholder provided legal advice regarding the formation of a charitable trust, using the power of attorney, and, based on his advice, the client created the trust. The client became executrix of the estate in April 2002 and beneficiaries of the estate filed objections to the executrix's final accounting. A trial was held in December 2006. The policyholder was deposed pursuant to this trial. The client lost at trial and was surcharged \$1.8 million. Included in this surcharge were all gifts and fees paid to the policyholder. The court based its adverse determination on a finding that the client had insufficient authority to create the trust, failed to keep adequate records, improperly executed the trust, and improperly administered the trust. The policyholder then informed the client on August 9, 2007, that "you now have a potential claim against me ... I believe that it would be prudent for you to seek new counsel... I am required to put my liability carrier on notice. After doing such, it would not be proper for me to continue representing you." The client did so.

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Despite this statement, the policyholder did not put his liability carrier on notice. On January 30, 2008, the policyholder applied for an insurance policy with the defendant in this action. The policy application stated that "it is important that you report any currently known claims or circumstances that could result in a claim to your current insurer ... [the defendant insurer] will not provide coverage for claim or incidents which are you aware of prior to the inception date of this coverage if offered and accepted." The application also separately excluded "all known claims and/or circumstances that could result in a Professional Liability claim" from coverage and included yet another "important notice" that failure to report such claims may create lack of coverage. The policyholder did not report the circumstances regarding the power of attorney and trust, described above. The policy itself also stated that the insurer would "pay on behalf of the insured ... provided that ... at the inception of this policy the insured had no *reasonable basis to believe* that any insured had breached a professional duty and no *reasonable basis to believe* an act, error, omissions or Personal Injury might be expected to result in such Claim or Suit." On June 4, 2008, after the trial judge entered a second judgment against the now-former client and a failed appeal, the former client's attorney contacted the policyholder and informed him that he should reimburse the former client for the amounts surcharged. Later that day, the policyholder put the insurer on notice.

The insurer denied coverage, stating that the policyholder "had a reasonable basis to believe that his acts, errors or omissions created a potential claim against him prior to the inception of his insurance policy." The policyholder then filed this declaratory action seeking a determination that the insurer has a duty to defend and indemnify the underlying action, and seeking damages for breach of contract and bad faith. Both parties moved for summary judgment.

The court applied the test from *Selko v. Home Insurance Co.*, 139 F.3d 146, 152 (3d cir. 1998) to determine whether the insured "had a reasonable basis to believe in the existence of facts would act to exclude policy coverage." The test required that:

First, it must be shown that the insured knew of certain facts. Second, in order to determine whether the knowledge actually possessed by the insured was sufficient to create a "basis to believe," it must be determined that a reasonable lawyer in possession of such facts would have had a basis to believe that the insured breached a professional duty.

The court noted that the test "is both subjective and objective in nature" and the "insured's subjective belief that he was not subject to liability is nondispositive." However, the court put the burden on the insurer "to prove what particular facts were known to the insured, and that based upon such facts, a reasonable lawyer in the same position would have concluded that liability was possible."

The policyholder claimed his former-client's current counsel "questioned why [he] would notify his liability carrier about the judgment against [the former client], and ... informed [him] that he had done nothing incorrect." The insurer contested "this averment vociferously," and noted that in the counsel's deposition testimony, he stated that "though he conversed with [the policyholder] about the matter of the judgment ... he never provided ... any advice regarding potential claims against [the policyholder] and whether he should

notify his liability carrier." The court quickly determined that "the conflicting testimony ... raise issues of credibility, which are issues that need to be resolved by a jury." Accordingly, the court held that the issues regarding coverage were not "amenable to disposition at summary judgment."

Next, the court addressed the bad faith claim, stating that a "heightened burden of proof is required of a plaintiff seeking relief for bad faith: clear and convincing evidence ... that (1) the insurer did not have a reasonable basis for denying coverage, and (2) the insurer knew or recklessly disregarded its lack of reasonable basis." The court also noted that these are fact specific claims that require an analysis of the insurer's conduct toward the insured. The court determined that to "rebut a bad faith claim ... an insurer need only show that it conducted a review or investigation sufficiently thoroughly to yield a reasonable foundation for its action... [T]he insurer, however, does not need to show that its investigation yielded the correct conclusion or even that its conclusion more likely than not was correct." Applying this standard, the court held that the "plaintiff did not adduce any evidence of bad faith, ill-will, self-interest, or dishonest purpose in defendants' determination." Accordingly, the court found that the policyholder "failed to provide the evidentiary basis required to show the existence of a genuine issue of material fact" and granted the insurer's motion for summary judgment on this issue.