

This edition features critical information for insurance agents and brokers, insurance carriers, health care providers and practitioners in these areas of law.

The Superior Court, in cases handled by this office, has made pronouncements in two very important arenas - public policy under the MVFRL and the duty of an agent/broker toward an insured. In the Nesser case, the Superior Court upheld the "household exclusion" in favor of a carrier represented by John Bogut, Jr. of this office. Upholding the decision of the trial court, which overturned an arbitration award in this UIM claim, the Superior Court held that the exclusion was unequivocal and enforceable, noting that the policy behind the MVFRL is to avoid carriers assuming risks for which they have been paid no premium. This was a major victory for carriers.

In Al's Cafe, Inc., the Court includes language that indicates its recognition of a duty on the part of an agent or broker, at least in a surplus lines situation, to investigate or



know the financial stability of a carrier with whom coverage is placed. Greg Knight's article discussing this decision provides guidance to the many agents and brokers our office represents, as well as to all who practice in this field.

Richard McMillan takes a careful look at the recent Haugh decision and the red flag it raises for carriers in the bad faith arena.

Finally, April Morgan of our office discusses one of the few victories an insurance carrier facing a bad faith claim in West Virginia has enjoyed in quite some time, detailing a recent decision where the court has upheld the privileged nature of attorney/client communications sought to be discovered by a plaintiff.

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*As always, we hope you find the included items interesting and useful. If you know of anyone who might benefit from Your Best Defense and who is not currently on our mailing list, please contact me at [dforsythe@waymanlaw.com](mailto:dforsythe@waymanlaw.com).*



## UPHOLDING THE HOUSEHOLD EXCLUSION

By: John C. Bogut, Jr.

In a recent memorandum opinion, the Pennsylvania Superior Court has further clarified the validity and scope of applicability of the "household exclusion" relative to a claim of entitlement to underinsured motorist (UIM) coverage.

On March 21, 2003, Wayman Irvin & McAuley, LLC successfully represented Harleysville Mutual Insurance Company in a suit brought by their insured, because of this

unwillingness to provide UIM benefits based upon the "household exclusion" in its insurance policy. In Harleysville Mut. Ins. Co. v. Nesser, Mrs. Nesser alleged injuries while a passenger on a motorcycle that was not insured by Harleysville. The motorcycle had been insured without UIM coverage by a different insurer. However, Harleysville insured the Nesses through a separate automobile policy which provided UIM coverage.

*The Harleysville "household exclusion" provided: For "bodily injury" sustained ... By a "family member," ... who owns an auto, while "occupying," or when struck by, any motor vehicle owned by you or any "family member" which is not insured for this coverage under this policy.*

The insureds argued that the "household exclusion" on which Harleysville relied was ambiguous. The Superior Court upheld the trial court's decision vacating the arbitration panel's conclusion that the exclusion was ambiguous. The Superior Court held that the trial court had the authority to modify the award because the arbitration panel's interpretation of the policy was erroneous as a matter of law. Also, the Court stated that the "provision in question unequivocally excludes UIM coverage for injuries sustained

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**INSURANCE AGENTS & BROKERS NEW DUTY**

*By: Greg Knight*

Pennsylvania insurance brokers should be aware of their new duty to clients in light of a recent decision of the Superior Court. Attorneys from this office participated in what turned out to be a procedurally painful case, the court announcing that insurance agents and brokers now have a new duty with regard to surplus lines carriers.



The case of Al's Café Inc. v. Sanders Insurance Agency, (2003 PA Super), was decided by the Superior Court on Friday March 21, 2003. In the case, plaintiff, Al's Café, Inc., appealed the entry of Summary Judgment against it. Al's Café was contacted by Sanders Insurance Agency about purchasing liquor liability insurance. Sanders placed the \$500,000.00 policy with Pine Top through Gateway and Hull. As it turns out, Pine Top was not registered to do business in Pennsylvania. During the coverage period, a claim was made by plaintiff for coverage and defense of a claim by George Andreen. However, Pine Top was in liquidation and unable to defend. Plaintiff hired private counsel, and a verdict was entered on this underlying case of \$429,635.29.

Al's Café sued Sanders in negligence, Sanders in turn joining Gateway, who in turn joined Hull and Co. The plaintiff herein and the plaintiff in the underlying case eventually received \$361,736.42 from Pine Top's liquidator. Then, when the instant case was re-listed, the defendants moved for Summary Judgment on the basis that there was no damage. This was argued on the theory that, if Pine Top had been registered to do business in Pennsylvania, then the case would have been defended and covered up to the \$300,000.00 statutory ceiling under PIGA (40 P.S. §§ 991.1801-1820). Therefore, since the plaintiff received more than the statutory cap from the liquidation, the negligence suit against the agents and brokers should be dismissed because there were no damages. Additionally, the agents and brokers argued that they had no duty to predict Pine Top's insolvency. The panel of the Superior Court, which noted the lack of trial court opinion, disagreed with these arguments and proceeded to analyze the issues based on the briefs of the parties and the record. The Superior Court decided the gravamen of the plaintiff's Complaint was whether the agent and/or brokers met their professional and statutory obligations with respect to the placement of the requested insurance.

In this case of first impression, the Superior Court discussed various common law and statutory provisions in

reaching the substantive law that would be applicable to this case. First, it was noted that an insurance agent or broker has a duty not to misrepresent the coverage purchased. The Court also discussed the case Rempel v. Nationwide Ins. Co., 471 Pa. 404, 370 A.2d 366 (1977), in which the Supreme Court specifically adopted the Restatement of Torts § 522 for negligent misrepresentation in insurance agent/broker cases. The Court then discussed the Pennsylvania Surplus Lines Law, 40 P.S. §§ 991.1601-1625. The statute basically provides that a "surplus lines" insurer is a nonadmitted insurer which may be used if: 1) comparable coverage cannot be obtained from an admitted insurer after a diligent search; or the type of coverage is not generally available; or the kind of coverage is a unique form of coverage; and 2) the nonadmitted insurer is of good repute and financial integrity. 40 P.S. § 991.1605(a).

The Superior Court then used the foregoing law to set forth the substantive standard under which the Court would examine the pleadings and discovery holding: an insurance agent's/broker's recognized duty to act with reasonable care, skill, and judgment extends to selection of the insurer and ascertaining whether it is reputable and financially sound and informing the insured of findings if investigation reveals evidence of financial infirmity, but the agent/broker nonetheless intends to place a policy with that insurer. Failure to comply with such duty may render the agent/broker liable to the insured that is unable to satisfy a claim due to the insolvency of the insurer. At least with respect to placement of insurance with a surplus lines insurer, it is clear that Pennsylvania law is in step with those jurisdictions recognizing that an insurance agent/broker has an obligation to investigate the financial soundness of the insurance carrier with which the agent/broker places insurance and to refrain from placing insurance with a carrier that the agent/broker knows or should know to be financially unsound.

Based on the above standard, which is arguably dicta, the Court remanded to the trial court to decide the factual issues based thereon.

Insurance agents and brokers in Pennsylvania need to be aware of this new duty when placing insurance with a surplus lines carrier. However, the does not address exactly which brokers/agents in the chain of distribution have this duty. Additionally, the Court does not address what act or acts will satisfy this duty. Basically, the Court is saying that the agent/broker needs to be aware of and inform the client of the financial status of the surplus lines carrier they

intend to underwrite the policy. This may be as simple as informing the client of the carrier's published ratings, but more may be required. At this time the law is unclear. In the face of this challenge, it is advised that insurance agents/brokers writing policies with surplus lines carriers proceed with caution. Agents should also anticipate that policyholders will argue, in litigation, that the duty to

investigate applies to the placement of all policies and not just surplus lines. ■

*Please feel free to contact Greg Knight or any of our attorneys with any questions or concerns in this area of law. Greg can be reached at [gknight@waymanlaw.com](mailto:gknight@waymanlaw.com).*

### **HAUGH DECISION BLOWS DOOR OPEN WIDER**

*By: Richard McMillan*



What's uglier to an insurance company than the "Big Bad Wolf"? If you guessed the Big "Bad Faith" you'd be correct. Paying more than the coverage limit of the policy is certainly one of the worst nightmares for insurers. Now, the door has been opened somewhat wider for insurers to be hit for bad faith as a result of the recent decision of the Court of Appeals for the Third Circuit in Haugh v. Allstate Insurance Company, 332 F3d 227 (C.A.3d, Pa.,2003).

Allstate had a \$15,000 policy limit on an auto involved in a motor vehicle accident. Initially, plaintiff's counsel was willing to settle within the policy limit, but Allstate indicated that it was denying the claim because, based upon its investigation, it had determined that its insured was not at fault. Plaintiff's counsel indicated that there would only be a limited opportunity to settle the case for the policy limits, and that time period of thirty days expired before the carrier later contacted the attorney to say that it would be willing to settle at the policy limit. By that time, plaintiff's counsel chose to decline the offer to settle for that amount, and he filed a lawsuit against Allstate's insured.

Allstate's adjuster informed the insured that it had hired an attorney to represent him in the lawsuit, that the damages claimed could exceed the policy limits, that a verdict in excess of the \$15,000 policy limit would result in personal liability, and that the insured had a right to retain his own attorney if he chose to do so at his own expense. More than a year after the plaintiff's offer to settle for the policy limits had automatically been revoked, Allstate decided to offer \$15,000 to settle the case, but the offer was declined and the case proceeded to trial. Approximately three years after the original opportunity to settle the case for \$15,000, a jury awarded the injured plaintiff \$740,000! (Since the accident had occurred almost five years before the verdict, the delay damages added to the verdict would place the amount to be recovered around one million dollars.)

Allstate's insured agreed to assign his rights concerning any potential bad faith claims against his insurer to the injured party/verdict winner, Haugh. Haugh, as assignee, then filed a bad faith claim against Allstate in federal court advancing both a common law contract claim for a breach of the contractual duty to act in good faith and a claim under Pennsylvania's Bad Faith statute, 42 Pa.C.S.A. Section 8371. The federal district court had granted Allstate's Motion for Summary Judgement based upon the expiration of more than two years from the date the original offer to settle the case for the policy limits had been withdrawn, which the court took as the date when a cause of action had accrued. The district court had reasoned that the claim brought under Pennsylvania's Bad Faith Statute was subject to a two year statute of limitations and that Pennsylvania did not recognize a separate common law bad faith action based on a common law contract claim.

The Third Circuit, however, decided that it was error for the district court not to apply the discovery rule under the circumstances to toll the running of the statute of limitations. The Third Circuit accepted the reasoning that because Haugh must be viewed as standing in the shoes of the insured who had assigned his rights against his carrier the statute of limitations must be viewed from the position of that insured. Critical to the outcome of this case was the fact that the adjuster never alerted the insured that the opportunity to settle the case within the policy limit had presented itself. Without evidence that the insured knew or should have known of the opportunity to settle within the policy limit, the statute of limitations would not begin to run until such time.

The Third Circuit also determined that the district court had misinterpreted Pennsylvania law as to whether a common law breach of contract action was available to the insured and, consequently, to his assignee. Citing the Pennsylvania Supreme Court case of Birth Center v. St. Paul Companies, Inc., 787 A2d 376 (Pa., 2001), decided after the district court had issued its decision, the Third Circuit held that despite the creation of a statutory right to sue under the Pennsylvania Bad Faith Statute, a common law right to sue

*Haugh Decision, continued from page 3*

under a contract theory still exists.

The Court rejected the insurer's argument that limiting the time to settle the case to a thirty day window constituted manufacturing a bad faith claim. The hostility of the Court to Allstate's position is clear by its comment that, "Indeed, it should be evident to anyone studying this case that Allstate by its conduct precipitated the claim here." Perhaps it was that hostility that led to what is perhaps the most significant aspect of the opinion.

While giving lip service to the idea that insurers are not under an absolute duty to settle a claim when there is a prospect of an excess verdict, the Court came out with the statement that "an insurer does not comply with the good faith standard when it refuses to settle merely because it

believes that its insured is not liable for the claim asserted," citing the Pennsylvania decision of LaRocca v. State Farm Mutual Automobile Insurance Co., 428 A2d 635, 638 (Pa. Superior Court, 1981). This case and those cited within the Court's opinion wave a red flag that is as bright as Little Red Riding Hood's cape warning about the dangers to look out for at the earliest stages of claim handling regarding the Big "Bad Faith." ■

*Richard McMillan or any of our attorneys will be happy to assist you with any questions in this complicated area. Contact Mr. McMillan at [rmmillan@waymanlaw.com](mailto:rmmillan@waymanlaw.com).*

### WEST VIRGINIA DECLINES TO CREATE NEW EXCEPTION TO ATTORNEY/CLIENT PRIVILEGE IN BAD FAITH ACTION

*By: April Morgan*



The West Virginia Supreme Court of Appeals recently addressed the application of the attorney/client privilege in third-party bad faith litigation on a writ of prohibition. The defendant insurance company asked the Supreme Court to prevent the enforcement of the Circuit Court's order directing the production of the complete claim files developed in connection with an underlying medical malpractice claim. The defendant argued that the files contained information protected by the attorney/client privilege. Declining to create a new exception to the attorney/client privilege for third-party bad faith cases, the Supreme Court granted the writ.

In the underlying medical malpractice case, Mrs. Verba's estate brought action against Dr. David A. Ghaphery for surgical complications resulting in her death. Following a favorable jury verdict in excess of \$2,500,000, but before the appeal, the plaintiff was granted leave to amend its complaint to allege that Dr. Ghaphery's medical insurer, Medical Assurance, had committed "bad faith" by violating the Unfair Claim Settlement Practices Act, West Virginia Code § 33-11-4(9). The bad faith action was stayed pending the resolution of the appeal.

Once resolved, discovery in the bad faith action commenced. Among other things, the plaintiff requested the complete investigative and claim files of Medical Assurance from the underlying action including all communications of any representative of Medical Assurance with Dr. Ghaphery attorneys.

Medical Assurance asserted the attorney/client privilege precluded the discovery of the materials sought. The plaintiff moved to compel a production of the documents which the Circuit Court granted, ruling that Medical Assurance had to produce all documents except for those exclusively between Dr. Ghaphery and his attorney that were not received and/or reviewed by Medical Assurance. The Circuit Court found that privileged communications between Dr. Ghaphery and his attorneys do not remain privileged if they are shared with Dr. Ghaphery's liability insurer.

In reaching this result, the Circuit Court relied solely upon Footnote 8 of Honaker v. Mahon, 210 W.V. 53, 62, 552 S.E. 2nd 788, 987 (2001). The footnote says in pertinent part: "An insurance company owes its own policyholders a duty... to refrain from statutory unfair claim settlement practices... these duties are not delegable and insurance companies are therefore responsible for the actions of the attorneys they employ."

The Circuit Court interpreted this footnote to mean that no privilege attaches to the communications between the insured and his attorneys if communicated to the insurer. Thus, the Circuit Court reasoned that Medical Assurance could not be permitted to withhold any documents requested by the plaintiff, except for those communications exclusively between Dr. Ghaphery and his attorneys.

The Supreme Court found that the Circuit Court had committed an error of law in applying Honaker to the present matter. First, the Supreme Court noted that all new points of law must be articulated through syllabus points according to the West Virginia State Constitution. Thus, no new exception to the attorney/client privilege could be articulated through a footnote, and the application of the footnote in this manner

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1. We will provide effective and cost-efficient legal services.
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4. We will answer your questions, address your concerns and respect your wishes in handling the lawsuit assigned to us.
5. We will provide status reports as any significant events occur in accordance with your policy.
6. We will assign the litigation to the attorney best suited to handle it.
7. We will use paralegals and law clerks where appropriate to ensure the most cost-effective handling possible.
8. We will retain experts or other third party service providers only upon consultation with and express approval by you.
9. We will consider alternative billing methods that are suitable to the type of case assigned and which do not restrict or interfere with effective legal representation.
10. We will make the best and most efficient use of technology both to represent your insured and our client and to avoid unnecessary legal fees.
11. We will provide itemized Statements for Services and adhere to any billing guidelines, structures or restrictions in place (as long as the same do not interfere with effective legal representation).
12. We will not transfer lawsuits between attorneys without your prior approval.

*West Virginia Declines, continued from page 4*

was improper.

The Supreme Court found that footnote 8 of Honaker addresses the insurer's duty to its own insureds, not to third parties, and does not create an exception to the attorney/client privilege as the Circuit Court found

The Court then discussed the application of the privilege. It is well established in West Virginia law that the attorney/client privilege extends to others who are advised of confidential information at the direction of the attorney. Therefore, the attorney/client privilege extends to protect communications between the attorney and his agents. Among these agents are representatives of the client's insurance company. Thus, privileged communications between Dr. Ghaphery and his attorneys remain privileged, even if shared with his liability insurer.

The plaintiff argued that even if the Circuit Court committed an error of law in applying Honaker, the Supreme Court should take this opportunity to adopt a balancing test whereby plaintiffs may obtain privileged documents upon a showing of compelling need in bad faith cases. Plaintiff argued that the elements of a bad faith action necessitate the discovery of communications between an insurer and its insured's counsel.

The Court declined to create an exception to the attorney/client privilege. The Court found a balancing test to be inconsistent with the plain language of Rule 26 of the West Virginia Rules of Civil Procedure. Rule 26 provides that "parties may obtain discovery regarding any matter, not

privileged, which is relevant to the subject matter involved in the pending action". The plain language of the Rule makes it clear that privileged materials, although relevant, are not discoverable.

The Court also noted that, in the small minority of states that recognize the right of a third-party plaintiff to bring a bad faith action against the defendant's insurance company, only two courts have addressed the issue presented in this case. Both declined to create a balancing test to determine the discoverability of attorney/client privileged materials.

The Court noted that the underlying purpose of the attorney/client privilege is to encourage the free-flow of information between the attorney and client and allow for an accurate evaluation and analysis of a case. The potential impact upon an attorney's ability to fully advise a client of a case, which could possibly include a "worse case scenario", would certainly be impeded if those communications would be discoverable in a subsequent bad faith action. The honest evaluation of a case benefits claimants because it often results in settlement, abrogating the need for a bad faith action to begin with.

Although this case was filed prior to the West Virginia Legislature's elimination of third-party bad faith claims in medical malpractice actions, West Virginia remains in the minority of states that recognize a right to bring a private cause of action against a tortfeasor's insurance company in other types of torts. The decision in this case is a rare win for the insurance industry in West Virginia courts. Given the favorable climate for bad faith litigation in West Virginia, the issue is certain to come up for review again. ■



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**Wayman Watch**

- *Congratulations to James Creenan on his selection as president of the Allegheny County Bar Association's Young Lawyers Division. Jim will serve as president-elect this year and assume the presidency for 2004.*
- *Mark Gesk recently represented the firm at the Summer Meeting of the Federation of Defense and Corporate Council in Quebec, Canada.*

*Upholding the Household, continued from page 1*

in an accident involving a household vehicle not insured by Harleysville.”

The main issue addressed by the court concerned the applicability of such a “household exclusion” pursuant to the Motor Vehicle Financial Responsibility Law (MVFRL). The insureds unsuccessfully claimed that the exclusion in the policy was both inapplicable to Mrs. Nesser and void as a violation of public policy.

The Superior Court relied upon the recent decision in Burnstein v. Prudential Property and Casualty Insurance Co., 809 A.2d 204 (Pa., 2002). The Court applied the Burnstein reasoning on the public policy issue which “focused upon whether the insurer was compelled to underwrite unknown risks that it had not been compensated to insure.” The Court had recognized that the dominant public policy behind MVFRL was the legislative concern for the spiraling consumer cost of automobile insurance. Consequently, the Court concluded that requiring insurers to underwrite risks for which premiums had not been paid would only frustrate the policy behind MVFRL.

The Harleysville decision is a continuation of the principle that the household exclusion is an appropriate representation of Pennsylvania public policy. The Superior Court remained consistent in its treatment of an identical household exclusion clause in Old Guard Insurance Co. v. Houck, 801 A.2d 559 (Pa. Super., 2002). There the Court reasoned that a correlation exists between premiums paid by the insured and the coverage the claimant should reasonably expect to receive.

In the instant case, the Superior Court determined that the “insureds under the Harleysville policy simply did not pay premiums for UIM coverage for other vehicles owned by members of their household but not insured by Harleysville.” The Court then reaffirmed the decisions made above by concluding public policy demanded that it allow application of the household exclusion in order to avoid requiring Harleysville to underwrite unknown risks for which it had not received compensation. ■

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