

This edition of Your Best Defense offers both a look at the potential for expansion of liability in the bad faith and design professional arenas and an analysis of new possible limitations on the liability exposure of real estate agents and other licensed professionals.

Kate Fagan in this edition tackles the issue of bad faith litigation. Examining a number of recent decisions in this area, Ms. Fagan looks at the *Brown v. Progressive* decision by the Superior Court and the possible expansion of the determination of just who can be seen as an insurer for bad faith purposes. A careful look at the issuing documents, as well as the actions of the potential insurer, is needed to be able to make any conclusions in this area. The practices of the carrier in the evaluation and investigation of claims are also seen to be under careful scrutiny in the recent *Hollock v. Erie* case.

The potential expansion of design professional liability is addressed by Marla Presley. In the landmark *Bilt-Rite* decision, the economic loss doctrine, which has long protected design professionals from liability to parties with whom there was no contractual relationship, is undermined. Ms. Presley carefully examines the decision and how liability to foreseeable third parties is now seen as potentially flowing from a contractual relationship of a design professional (or anyone who provides information upon which others rely) with the entity retaining it.

On the other hand, liability to real estate agents and other licensed professionals may be more limited than in the past. Michael Magulick addresses the relatively new MCARE Act and the new requirement that



a certificate of merit must be issued within sixty days of the filing of the complaint against certain licensed professionals. This certificate of merit would establish that an expert has determined that there is reasonable probability that a breach of professional standard has occurred and that the same caused the claimed injuries. This requirement is designed to prevent frivolous lawsuits by requiring expert involvement at the very start of the litigation.

Jeffery Kubay in this edition looks at the recent *Youndt* decision and how the Superior Court has now in effect eliminated the “real estate inspection exception” to defenses based upon contract integration clauses and limitations on liability. In a commercial transaction, as opposed to a residential deal, agents and brokers were found to be insulated from liability from pre-contract representations where the contract of sale contains appropriate “as is” language and an integration clauses.

The law is ever-changing, and the expansion or contraction of liability on the part of potential defendants is always being modified, refined, clarified and polished. This edition of *Your Best Defense* hopes to provide some insight into at least a small portion of this evolution.

If you know of anyone who is not on our mailing list and who might want to read our Newsletter, or if you have any suggestions for topics to be addressed, please e-mail me at dforsythe@waymanlaw.com.



RECENT CASE LAW LIMITS THE LIABILITY OF REAL ESTATE AGENTS FROM MISREPRESENTATION CLAIMS IN COMMERCIAL TRANSACTIONS

By: Jeffrey A. Kubay

representations are not admissible in a misrepresentation lawsuit where the contract contains standard integration and “as is” clauses. *Youndt d/b/a West Pike Motor Lodge v. First National Bank of Port Allegany and North Country Real Estate*, 2005 Pa.Super 42 (February 2, 2005). This decision essentially upholds the law of contract’s parol evidence rule - where a written agreement was intended to encompass the parties’ entire understanding, alleged prior or contemporaneous oral representations or agreements concerning subjects that are specifically covered by the written contract (i.e. “parol evidence”) are merged in or superseded by that contract.

In *Youndt*, plaintiffs brought an action for fraudulent misrepresentation arising from a commercial real estate transaction. Defendant First National Bank owned a parcel of commercial real estate known as West Pike Motor Lodge and hired defendant North Country Real Estate to sell the property. North Country’s agent allegedly informed plaintiffs that there were no problems with the property. Plaintiffs and the Bank entered into a written agreement for the sale of the property. The

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agreement contained a standard “as is” clause that stated that plaintiffs were purchasing the property “in its present condition.” The agreement also contained an integration clause that provided that the agreement contained the whole agreement between the seller and the buyer and that there were no other terms, representations, statements or conditions concerning the sale.

Plaintiffs’ lawsuit alleged fraud in the inducement based upon the agent’s alleged representation. Defendants obtained a pre-trial dismissal of the case based upon the “as is” and integration clauses. On appeal to the Superior Court, plaintiffs argued that, because their action was based upon a fraudulent misrepresentation in the inducement of the contract, parol evidence of the misrepresentation was admissible to prove their claim under Pennsylvania law.

Pennsylvania courts have clearly addressed “fraud in the inducement” claims. The applicable case law provides that when a plaintiff would never have entered into an agreement but for a fraudulent representation, no valid agreement can come into being, and thus, parol evidence is admissible to show that the agreement is void. Nevertheless, the case law also provides that a party cannot justifiably rely upon prior oral representations yet sign a contract that contains an integration clause denying the existence of those representations.

However, plaintiffs correctly argued on appeal that Pennsylvania law recognizes a “real estate inspection” exception applicable to claims for fraud in the inducement, notwithstanding the fact that the agreement of sale contains an integration clause. This exception has originated from the so-called “real estate inspection cases,” including *LeDonne v. Kessler*, 389 A.2d 1123 (Pa.Super. 1978), which have permitted parol evidence even where the written agreements contain integration clauses. These cases almost always involve the sale of residential property. In *Youndt*, plaintiffs argued that the *LeDonne*/real estate inspection exception should apply to permit the introduction of parol evidence at trial in the form of the agent’s alleged misrepresentation that there were no problems with the subject commercial property.

The Superior Court in *Youndt* declined to extend the *LeDonne*/real estate inspection exception to commercial real estate transactions. The Court concluded that a seller of commercial real estate must be permitted to contractually limit liabilities arising from the condition of the subject property through the inclusion of specific contractual provisions, and that the other party may not circumvent such provisions by a vague allegation of fraud

in the inducement, such as the alleged misrepresentation at issue in the *Youndt* case.

The Superior Court distinguished the *Youndt* and *LeDonne* cases by reasoning that *LeDonne* involved a residential real estate transaction and a much narrower integration clause. The plaintiffs in *LeDonne* brought a claim for fraudulent misrepresentation stemming from alleged misrepresentations regarding the quality and condition of a property’s sundeck, cellar, and septic system. The Superior Court’s analysis in *LeDonne* hinged on the fact that the contract therein only disclaimed liability for representations as to defects that would be apparent through visual inspection alone. The *LeDonne* Court had concluded that the plaintiffs were precluded by the parol evidence rule from offering testimony regarding pre-contract representations concerning the quality and condition of a sundeck and cellar because there was evidence that the plaintiffs visually inspected those areas before signing the agreement. However, the *LeDonne* Court found that, with respect to the property’s septic system, plaintiffs could maintain their cause of action because the septic system was underground, and plaintiffs could not have possessed full knowledge of its physical appearance and adequacy, nor could they have readily ascertained whether a drainage problem existed.

The Superior Court’s decision in *Youndt* is significant, as it serves to insulate sellers of commercial property and their real estate agents/brokers from liability from alleged pre-contract misrepresentations where the agreement of sale contains appropriate “as is” and integration clauses. However, sellers and agents must remain mindful of any pre-contract oral communications with prospective buyers. Agents cannot make affirmative representations about conditions of the property of which they possess no information. Indeed, Pennsylvania law imposes a duty to ascertain the nature of certain conditions prior to making representations about those conditions. Further, agents are required to disclose any known latent defects. Nonetheless, real estate agents are not required to make an independent verification of information provided by the seller unless facts personally known to the broker lead him/her to believe that the information provided by the seller is false.

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PENNSYLVANIA SUPREME COURT UNDERMINES ECONOMIC LOSS DOCTRINE PROTECTION

By: Marla Presley

A landmark decision recently handed down by the Pennsylvania Supreme Court ended years of debate and speculation by ruling that contractors could sue design professionals directly for negligent misrepresentations. In *Bilt-Rite Contractors, Inc. v. The Architectural Studio*, decided January 19, 2005, the Supreme Court formally adopted Section 552 of the Restatement (Second) of Torts, finding that the economic loss doctrine no longer protected design professionals for negligent misrepresentation claims.

Bilt-Rite is a construction firm based in Bucks County Pennsylvania that was awarded a winning bid to work on school construction for a project in Lehigh County. The Architectural Studio created the plans, specifications and drawings used for the bidding and construction of this project. The architect stated that the construction could be completed with reasonable construction means and methods. However, upon commencement of construction, Bilt-Rite determined the construction could not be completed using normal means and methods and was faced with severe cost overruns. Bilt-Rite alleged that once construction commenced, it discovered that constructing the systems in the specifications required it to “employ special construction means, methods and design tables, resulting in substantially increased construction costs.”

Bilt-Rite sued The Architectural Studio in 1999 on a theory of negligent misrepresentation under Section 552, alleging the drawings and specifications prepared by The Architectural Studio were misleading. In 2000, the trial court dismissed the suit, partially because there was no contract between the architect and the contractor.

In affirming the trial court’s decision, the Superior Court of Pennsylvania relied on its 1992 decision in *Linde Enterprises, Inc. v. Hazelton City Authority*, 602 A.2d 897 (Pa.Super. 1992). In *Linde* the Court held that a contractor was barred from recovering against an architect for purely economic losses suffered as a result of the negligent preparation of specifications without a contractual relationship between them.

Prior to the *Bilt-Rite* decision, the Supreme Court had previously cited Section 552, but always stopped short of formally adopted it. In *Bilt-Rite*, the Supreme Court determined that the formal adoption of this Section of the Restatement (Second) of Torts was consistent with Pennsylvania common law and further that there is no

requirement of a contractual relationship in order to recover under Section 552. The Court held that there is no need for a contract between the contractor and the design professional because “the duty to foreseeable third parties flows from the architect’s contractual duties to the party retaining the architect.” The Supreme Court further determined that the contractor was a foreseeable user of the plans and specifications, that the design professional knew that the contractors bidding on the project would rely on them and that the design professional knew that the contractors would suffer harm if the plans and specifications were prepared negligently. The Court held that the economic loss doctrine “does not bar recovery in such a case.”

The Supreme Court did, however, recognize that a design professional’s liability for economic damages to third parties cannot be without limits and that Section 552 of the Restatement (Second) of Torts is sufficiently narrowly tailored to insure appropriate limitation. It is also undetermined whether *Bilt-Rite* will apply beyond its facts to abolish the economic loss doctrine defense in claims other than those by a contractor based on design documents.

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UPDATE ON BAD FAITH DECISIONS

By: Kate J. Fagan

The threat of bad faith claims to insurers under Pennsylvania’s Bad Faith Statute, 41 Pa.C.S.A. §8371, remains very real and of grave concern. Since the statute’s inception in 1990, there have been numerous appellate court decisions that have defined and expanded the concept of what constitutes bad faith activity.

The statute provides as follows:

In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:

- (i) award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus three percent;
- (ii) award punitive damages against the insurer;
- (iii) assess court costs and attorney’s fees against the insurer.

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As case law has evolved since the passage of the Bad Faith Statute, bad faith conduct has been defined in a number of different ways. Bad faith conduct can exist when an insurer, having no reasonable basis, denies benefits under the terms of the policy for which the insured has paid a premium. There is also a consideration of the standard that the insurer, through its employees, acts in a reckless, willful or wanton manner in failing to formulate a reasonable basis for denying the claim under the terms of the policy. Acts of bad faith, through case law, have been determined to also include a failure to perform an appropriate investigation into the facts of the incident at hand and failure to appropriately communicate with the insured or his counsel. Having said this, it should be noted that simple negligence or bad judgment does not constitute bad faith. The plaintiff bears the burden to show that the insurer breached a duty of good faith through some suspect motive. Claims adjusters and supervisors should take care to properly and carefully investigate the claim in a timely fashion and to prepare claims file notes and reports with care. Thoughtful evaluation should be given as to the value of the insured's claim.

In 2003, the Pennsylvania Supreme Court, in *Mishoe v. Erie Insurance Company*, 824 A.2d 1153 (2003), determined that the Bad Faith Statute sets forth that if the "court" finds that an insurer has acted in bad faith, the "court" may take certain actions. The Supreme Court in *Mishoe* decided that it was the intent of the legislature, by using the word "court", to have bad faith cases heard by trial judges and not by a jury. The claim of the insured in *Mishoe* that there was a right to jury trial under the Bad Faith Statute was rejected. The Court also determined that, under the terms of the Pennsylvania Constitution, bad faith claims did not exist at the time the Constitution was adopted and, therefore, there was no constitutional right to a jury trial in the statutorily-created action. It is interesting to note, however, that, if a bad faith case is filed in federal court, the federal court permits a jury trial on the bad faith issues based on the Seventh Amendment of the United States Constitution.

Despite the fact that the Pennsylvania courts finally settled the issue of jury versus non-jury trial, many other issues have been addressed by the appellate courts in bad faith cases in recent years.

Of some note is the case of *Toy v. Metropolitan Life Insurance Company*, 2004 W.L. 2349550 (Pa. Super. Ct. October 20, 2004). This was a case which involved alleged deceptive trade practices and the plaintiff's claim that Metropolitan Life Insurance Company fraudulently induced her to purchase a life insurance policy all the while representing that the policy was some form of a savings

plan. While there were other counts incorporated into the action, the plaintiff set forth a count that the conduct of Metropolitan Life Insurance Company violated Pennsylvania's Bad Faith Statute. At trial, the trial judge dismissed the bad faith count of the plaintiff's Complaint, asserting that the plaintiff was required, but had failed, to establish justifiable reliance on Metropolitan Life's misrepresentation. The Superior Court has affirmed the trial court's decision, but on other grounds. The Superior Court found that any claim under the Bad Faith Statute required proof that the insurer lacked a reasonable basis for denying benefits and that the insurer knew or recklessly disregarded its lack of a reasonable basis. The Superior Court concluded that the plaintiff's allegations as set forth in the Complaint concerning misrepresentation on the part of Metropolitan Life did not state a cause of action or claim under the Bad Faith Statute.

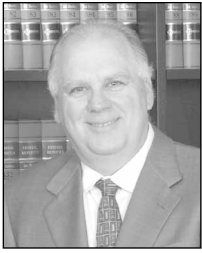
Underinsured/uninsured motorist claims remain a hotbed of bad faith litigation. Two cases of note were decided during 2004.

In *Brown v. Progressive Insurance Company*, 860 A.2d 493 (2004), the plaintiff instituted a bad faith action and claimed that Progressive had failed to properly evaluate the value of the claim. It was further alleged that Progressive also had unreasonably delayed a resolution of the claim by failing to respond to counsel for the plaintiff for a period of over two years. Progressive denied all liability, but also argued that Progressive was not an "insurer" under the meaning of §8371. Progressive asserted that an affiliated entity, Mountain Laurel, and not Progressive, was actually the issuing insurer and was listed on the declarations page as such. While the trial court found that Progressive had acted in bad faith, the Superior Court reversed the trial court's findings. However, the Superior Court did find that Progressive was an "insurer" within the meaning of the statute. The Court looked to a two-part test which involved looking to (1) the extent to which the company was identified as the insurer on the policy documents and (2) the extent to which the company acted as an insurer. Progressive was identified as an insurer in policy documents, including on the declarations sheet, and, therefore, was held to be an insurer. No appeal was taken from this case.

The *Brown* case has expanded the idea of who may be an insurer, and carriers should look carefully to issuing documents which identify the insuring body.

Finally, in 2004, the Superior Court decided the case of *Hollock v. Erie Insurance Exchange*, 842 A.2d 409 (2004). This case deals with a close examination of claims-handling tactics and techniques where plaintiff asserted a

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STATUTE OFFERS PROTECTION TO LICENSED PROFESSIONALS

*By: Michael L. Magulick and
Marla Presley*

The recently enacted Medical Case Availability and Reduction of Error Act (MCARE) 40 P.S. 1303 101 and the corresponding Pennsylvania Rules of Civil Procedure contains provisions requiring attorneys who file lawsuits against licensed professionals to certify that they have consulted a qualified expert in the speciality of the proposed defendant and have obtained a written statement from that individual that the proposed defendant has breached a standard of care.

In order to satisfy that requirement of the statute, the attorney must file a Certificate of Merit that states that another licensed professional has “supplied a written statement that there exists a reasonable probability that the care, skill or knowledge exercised or exhibited in the treatment, practice or work ... fell outside acceptable professional standards and that such conduct was a cause in bringing about the harm”.

In addition to the written statement requirement, the Certificate can state that the claim against a particular defendant is based on that professional’s vicarious liability for another licensed professional/defendant. In that case, a Certificate must have been filed against the licensed professional whose conduct deviated from the standard of care. Finally, the Certificate can simply state that expert testimony will not be necessary to establish the professional’s negligence.

In multi-defendant cases, the plaintiff must submit a Certificate of Merit for each licensed professional who is named as a defendant.

If a defendant joins a licensed professional as an additional defendant, then the joining defendant must file a Certificate of Merit against the proposed additional defendant *unless* the joinder is based on the same factual scenario and alleged negligent conduct. For example, if a plaintiff sues a physician based on the allegation that the physician deviated from the appropriate standard of care in treating a compound fracture, the joinder of the assisting physician would not require a Certificate of Merit, but the joinder of the radiologist would require a Certificate of Merit.

The Certificate of Merit should be filed with the Complaint but no later than 60 days after the Complaint is filed.

The trial court may extend the deadline for filing of the Certificate of Merit upon good cause shown for a period not to exceed 60 days. However, there is no limit to the number of extensions that may be obtained. Extensions

will likely be granted if counsel was retained only shortly before the expiration of the Statute of Limitations or if medical records required for a complete review have been requested but have not been provided. In all instances, the moving party must show due diligence to obtain the extension.

The most important thing to remember is that extensions must be obtained *prior to the expiration* of the allowable time.

Pre-Certificate discovery is permitted by the new Rules of Civil Procedure, but this will be limited to Requests for Production of Documents or Requests for Inspection. Basically, the plaintiff can obtain the medical records, client file or other documents necessary for the qualified expert to evaluate the validity of a potential claim.

A plaintiff may not proceed to general discovery against a licensed professional until the Certificate has been filed. Only Requests for Production of Documents and Requests for Inspection may be served before the Certificate has been filed. Of course, the trial court may grant leave for specific discovery needed to obtain information to support the written statement and Certificate of Merit.

Rule 1042 of the Pa. Rules of Civil Procedure provide the manner in which issues relating to the Certificate of Merit can be challenged.

In addition to the newly enacted sanctions available under Rule 1023.4 for improper certification, professionals should be encouraged that the written statement must be produced by the plaintiff at the conclusion of the proceedings against the licensed professional. Therefore, the licensed professional can compare the written statement and obtain sanctions after the lawsuit is concluded if the action was filed or the Certificate of Merit was prepared without proper factual or legal bases. Sanctions can be imposed on the party, the lawyer or the law firm.

The new rule represents a significant reform to lawsuits where a professional’s judgment is challenged after a “bad” outcome. Before the aggrieved plaintiff can commence the action, his/her counsel must now affirm that the case has merit after consultation with a qualified professional that has provided a written statement indicating that there has been a deviation from the standard of care. The Rule goes even further to afford professionals relief in the event a plaintiff fails to adhere to the letter and spirit of these mandates. Overall, the new rule should be expected to reduce the instances of truly frivolous litigation.

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Wayman Watch...

- *The firm is proud to announce the hiring of attorney Paul Isherwood. Paul was number one in his law school class at Duquesne University and will make an excellent addition to our professional staff.*
- *Dale Forsythe once again moderated the Liability/Auto Section for the Pennsylvania Claims Association's Western Pennsylvania Claims Seminar at the Radisson Hotel in Monroeville this past April. In addition to moderating, Dale also presented the annual General Liability Update. The written materials from this presentation are available under FYI on the firm's Web page.*
- *Wayman, Irvin & McAuley is celebrating its 40th year of practice this year. Stay tuned to upcoming editions and visit our Web site to learn more about the festivities being planned.*
- *Mark Gesk recently represented the office at the FDCC Spring Conference in Marco Island, Florida, where he presented to the Construction Law Section.*
- *The Construction Law practice group, including Mark Gesk, Francis McTiernan, Paul Mannix and James Creenan, recently began a series of roundtable presentations to design professionals at the Pittsburgh Engineers' Club.*
- *The firm is pleased to announce the selection of our office manager, Michael Somerhalder, as President Elect of the Pittsburgh Legal Administrator's Association. Congratulations, Mike.*

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bad faith claim as a result of Erie's handling of the claim. The plaintiff's assertions included the fact that the Erie claims handler did not inform the plaintiff's counsel concerning the correct amount of coverage available under the terms of the policy, that an unrealistic reserve on the claim was set despite receipt of medical records and documentation concerning large wage loss, and that no independent medical examination was conducted. Also, no investigation concerning the wage loss claim was made. After arbitration, the arbitrators entered an award in favor of the plaintiff which well exceeded the coverage of the underinsured motorist provision of the policy.

The trial court in the bad faith case awarded the plaintiff both compensatory and punitive damages which exceeded \$2,000,000.00. The Superior Court affirmed the trial court's award and found Erie's conduct to be egregious in its investigation, evaluation and handling of the claim.

No doubt there will continue to be much litigation in this area of law. The courts continue to examine and, in some cases, expand the ability of plaintiffs to recover for bad faith under the statute which was adopted nearly fifteen years ago.

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