

WHAT IS THE NATURE AND SCOPE OF “BAD FAITH” CONDUCT THAT CAN BE REMEDIED DIRECTLY UNDER THE BAD FAITH STATUTE, 42 Pa.C.S. § 8371

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A. OVERVIEW

In 2007, a 3 to 2 Opinion issued by then Chief Justice Cappy in Toy v. Metropolitan Life Insurance Company, 928 A.2d 186 (Pa. 2007) provided an interpretative overview on the Bad Faith Statute. This was based upon the Majority’s reading of the Bad Faith Statute’s history, and the limited scope of its essential nature. As will be detailed below, the Toy Majority identified a critical source of confusion in interpreting the Bad Faith Statute. This confusion is found in the how the term “bad faith” is used by the courts and lawyers.

The Majority found this single phrase, “bad faith”, to be used in two different ways with two distinctly different meanings. In one use, the phrase “bad faith” goes to the essential nature of the Statute, *i.e.*, the scope and purview of what the Statute is intended to remedy: the denial of benefits. In the second use, the term “bad faith” is used to describe conduct that provides the evidence entitling an insured to relief for the denial of benefits. Justice Eakin, in concurrence, would have rejected the Majority position as too narrowly defining the acts that may be remedied, and would have included a broader range of conduct within that sphere. He would have moved conduct from the category of merely constituting evidence of bad faith, into the category of providing a direct right to relief for that same conduct, even absent a denial of benefits. This was not the prevailing view in Toy.

Possibly because some of the Toy Majority’s critical reasoning is in footnotes, its conclusions have not readily found their way into subsequent case law. Rather, Justice Eakin’s view has gained a foothold with some courts in broadening the scope of conduct for which there is a direct Statutory Bad Faith remedy for conduct that goes beyond the denial of benefits. Pre-Toy Superior Court case law, and the Third Circuit’s non-precedential Opinion in Gallatin Fuels have played significant roles in the perpetuating the position that there is a remedy for conduct that may not include the denial of a benefit. It is also possible that a failure to distinguish between evidentiary conduct associated with delay in paying or providing the benefit -- which is fundamentally the denial of a benefit -- and that identical conduct where no benefit is ever going to be due, has caused confusion in the post-Toy legal universe.

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B. HOW THE MAJORITY OPINION IN TOY V. METROPOLITAN DEFINED THE “BAD FAITH” THAT CAN BE REMEDIED UNDER THE BAD FAITH STATUTE

The case law is not consistent on the issue of whether a successful breach of contract defense on the merits precludes the possibility of a bad faith claim. Put another way, must there be some breach of an insurance contract resulting in the denial of a benefit as a predicate to a successful Statutory Bad Faith claim? There is also a distinct issue of whether the bad faith claim can proceed if the breach of contract claim failed for a technical or procedural reason, e.g., missing the contractual period of limitations; or was somehow not pursued because, e.g., the matter settled.

In Toy v. Metropolitan Life Insurance Company, 928 A.2d 186 (Pa. 2007), a 3 to 2 majority of the Supreme Court construed the scope of permitted bad faith claims narrowly. In that case, the factual issue centered on an allegedly improper solicitation to purchase an insurance policy, which solicitation was a purported violation of the Unfair Insurance Practices Act. Writing for himself and two other Justices (on a panel consisting of five), Chief Justice Cappy looked to the Statutory Construction Act and found that the term “bad faith” had acquired a specific meaning in the insurance context at the time the legislation was enacted; that under the Bad Faith Statute the cause of action arose “under an insurance policy”; and that the statutory damages permitted were “based on the ‘amount of the claim from the date the claim was made by the insured.’” Expounding on this analysis, the Majority concluded that the statute did not permit claims for unfair practices involving the solicitation of a policy. It is the Court’s interpretation of what constitutes bad faith that is relevant for present purposes.

As to the specific meaning acquired at the time of the Statute’s 1990 enactment, “the term ‘bad faith’ concerned the duty of good faith and fair dealing in the parties’ contract and the manner by which an insurer discharged its obligations of defense and indemnification in the third-party claim context or its obligation to pay for a loss in the first-party claim context.” “In other words, the term captured those actions an insurer took when called upon to perform its contractual obligations of defense and indemnification or payment of a loss that failed to satisfy the duty of good faith and fair dealing implied in the parties’ insurance contract.” As will be discussed below, these are what the Majority describes as “cognizable” bad faith claims, i.e., claims for which relief can be provided under the Statute. This is contrasted with conduct that may be admitted as evidence of bad faith in establishing these cognizable claims.

Footnotes 16-18 explain and clarify the Supreme Court’s conclusion that “bad faith” means either failing to pay a loss in the first party context or denying a defense and indemnification in a third party context. These footnotes were written in large part to address Justice Eakin’s criticisms of the Majority’s conclusion that “bad faith” is limited to these two basic categories. Thus, footnote 16 begins: “The concurring opinion disagrees with our interpretation of § 8371, believing it to be too narrow and constrained by the particular fact patterns in Cowden ... and D’Ambrosio....”

The Majority then states: “It bears repeating that in this case, we determine the essence of the claim given to an insured under the bad faith statute.” Here, Justice Cappy uses the term

“essence” to set up the critical distinction between the nature and scope of the claim that the Bad Faith Statute provides to insureds, and the kind of conduct that may be used to prove that claim. He thus states: “As we observe in footnotes 17 and 18, we do not consider what actions amount to bad faith, what actions of an insurer may be admitted as proof of its bad faith, whether an insurer’s violations of the UIPA are relevant to proving a bad faith claim or whether the standard of conduct the Superior Court has applied to assess an insurer’s performance of contractual obligations in bad faith cases is the correct one.”

He then further clarifies by observing that there are two uses of the term “bad faith”. “In this area, the term ‘bad faith’ refers not only to [1] the claim an insured brings against his insurer under the bad faith statute, but also, [2] to the conduct an insured asserts his insurer exhibited and establishes that it is liable. These matters although related, are nonetheless, separate and distinct. We write to the former. The concurrence appears to write to the latter.” This is the critical distinction.

The contrast with Justice Eakin’s concurrence further clarifies that distinction. Justice Eakin’s Toy concurrence states that a section 8371 claim “is not limited to actions for an insurer’s wrongful failure to pay an insurance claim or disposal of its obligations of defense and indemnification.” This was certainly in direct response to the Majority’s position on the limited scope of cognizable bad faith claims. He argued that the Superior Court reached a different conclusion than the majority in finding the following types of claims actionable under section 8371: “considering whether insurer acted in bad faith in selecting neutral arbitrator, securing witness testimony, and permitting attorney to delay litigation”²; a lack of good faith investigation into facts, and failure to communicate with the claimant³; and investigatory practices of an insurer during litigation initiated by an insured to obtain the proceeds of his or her insurance policy.⁴

In reviewing these cases, the Majority responds: “In every one of the cases the concurrence cites ... to describe our view of § 8371 as unduly restrictive and inconsistent with the Superior Court’s perspective, the insured brought an action under § 8371, alleging that his insurer failed to satisfy his first party claim in the proper manner. The question before the court in each of those cases was not whether the insured alleged a cognizable claim under the bad faith statute. Rather, it was whether the evidence offered at trial by the insured as to the insurer’s behavior was sufficient to prove the bad faith claim and/or admissible in a § 8371 action.” The evidentiary matters in those cases were addressed to issues that “the record did not support the findings that the insurer failed to pursue a thorough independent investigation, treated the insured as an adversary; or failed to keep the insured informed”; the evidence supported the findings that the insurer improperly asserted that its insured concealed information or had prior knowledge of a structural problem with the roof and denied coverage on an unsupportable theory”; and “conduct by an insurer, whether occurring before, during, or after litigation of the bad faith claim

²Condio v. Erie Ins. Exch., 899 A.2d 1136 (Pa. Super. Ct. 2006), appeal denied, 912 A.2d 838 (Pa. 2006).

³Brown v. Progressive Ins. Co., 860 A.2d 493 (Pa. Super. 2004).

⁴Zimmerman v. Harleysville Mutual Ins. Co., 860 A.2d 167 (Pa. Super. Ct. 2004), appeal denied, 881 A.2d 820 (Pa. 2005); O’Donnell v. Allstate Ins. Co., 734 A.2d 901 (Pa. Super. Ct. 1999).

is admissible to show bad faith, but that the insured failed to present evidence of improper investigative tactics or an unreasonable denial of the claim”.

Justice Cappy also made the same point in his explaining dissenting statement in Hollock v. Erie Ins. Exch., 588 Pa. 231, 903 A.2d 1185, 1189 (Pa. 2006). He distinguished Hollock from the issue before the Toy Court on what constitutes cognizable claims within the Bad Faith Statute’s purview. In Hollock, the insured brought a claim under § 8371 alleging that her insurer failed to properly process and pay her claim for underinsured motorist coverage. The issue presented “was whether the conduct of the insurer during discovery and throughout the course of the trial on the insured’s bad faith claim should have been considered for purposes of establishing liability and setting the amount of the punitive damages award. The issue was not, as here [in Toy], whether the claim the insured brought against the insurer fell within § 8371’s purview, given the meaning of the statutory term ‘bad faith.’ 42 Pa.C.S. § 8371.”

Just a few months later, in Ash v. Continental Ins. Co., 932 A.2d 877 (Pa. 2007), in an opinion written by Justice Eakin, a clear majority of Pennsylvania’s Supreme Court followed Chief Justice Cappy’s Toy Opinion. In footnote 10 of the Ash Opinion, Justice Eakin writes: “The bad faith insurance statute, on the other hand, is concerned with “the duty of good faith and fair dealing in the parties’ contract and the manner by which an insurer discharge[s] its obligation of defense and indemnification in the third party claim context or its obligation to pay for a loss in the first party claim context.” See Toy v. Metropolitan Life Ins. Co., 928 A.2d 186, 199 (Pa. 2007). It applies only in limited circumstances--i.e., where the insured first has filed ‘an action arising under an insurance policy’ against his insurer, see 42 Pa.C.S. § 8371--and it only permits a narrow class of plaintiffs to pursue the bad faith claim against a narrow class of defendants.” Thus, Justice Eakin himself recognized that his position on the scope of cognizable bad faith claims had not prevailed, and accepted Justice Cappy’s narrower position that the Bad Faith Statute is in fact “limited to actions for an insurer’s wrongful failure to pay an insurance claim or disposal of its obligations of defense and indemnification.”

In Toy footnote 17, the Majority further amplified the difference between cognizable claims and evidentiary conduct. “We would end our discussion of Toy’s first issue here, but for our desire to clarify an assertion of Toy’s that has no merit. Toy contends that the Superior Court has repeatedly held that allegations of UIPA violations constitute a claim of bad faith under § 8371. The cases that Toy cites in her brief for support do not stand for this proposition, but rather, concern two questions raised by the bad faith statute with which the lower courts have been grappling, but which are not before us and remain for another day.” If Ms. Toy’s assertion were true, then UIPA violations that had nothing to do with a denial of benefits would provide for relief under the Bad Faith Statute, a position directly at odds with the Majority’s actual Opinion.

This is clarified by the Court in its identifying the true issues surrounding reference to the UIPA. “The first question concerns the role that the UIPA may play in the trial of a bad faith claim. Even though it is the Insurance Commissioner who enforces the statute, there are Superior Court decisions that conclude that an insured may ask the court to consider whether an insurer’s violations of the UIPA are *evidence* that an insurer acted in bad faith under § 8371 in handling a claim.” (Emphasis added). Thus, reference to the UIPA involves questions of evidence and

proof, not the scope of cognizable claims or the statute's purview. "The second issue concerns whether an insurer's conduct in litigating the bad faith claim that its insured asserts against it in a complaint may be considered by the court in determining whether and to what extent an insured is entitled to relief under § 8371." In footnote 18, in light of the Court's dismissing the claim because it was not cognizable, it did not have to rule of the Superior Court's standard of conduct used in bad faith cases, or whether the bad faith statute creates an independent cause of action or was a form of additional relief under a cause of action.

C. PRE-TOY CASE LAW

Prior to Toy, there was case law that bad faith claims could stand even absent any coverage obligation, but much of this law, though not all, was based upon the unusual procedural circumstances leading to the coverage claims' dismissal.

In Schubert v. Am. Indep. Ins. Co., No. 02-6917, 2003 U.S. Dist. LEXIS 10769 (E.D. Pa. Jun. 24, 2003), the court stated that "[c]ourts have ... held that a statutory claim under § 8371 can be maintained even before a contract claim has fully developed, and that a statutory claim can be successful even if the underlying breach of contract claim fails." This Court cited Doylestown Electrical Supply Co. v. Maryland Casualty Ins. Co., 942 F. Supp. 1018, 1020 (E.D. Pa. 1996) and March v. Paradise Mutual Ins. Co., 646 A.2d 1254 (Pa. Super. 1994), appeal denied, 540 Pa. 613, 656 A.2d 118 (1995). Both Doylestown Electrical and March involved dismissal of contract claims based on contractual statute of limitations, not on actual failure of the claims on the merits. In Schindler v. Berkshire Life Ins. Co., No. 98-5049, 1999 U.S. Dist. LEXIS 10414 (E.D. Pa. Jul. 9, 1999). The District Court observed that the cases in which the bad faith claim remains actionable are those cases where the "contract claim is barred by technical defenses, settled, or otherwise not litigated."

Doylestown Electrical was distinguished in a leading Third Circuit case, Frog Switch & Mfg. Co. v. Travelers Ins. Co., 193 F.3d 742, 751 n. 9 (3d Cir. 1999). In Frog Switch, the Third Circuit stated that where there was a substantive finding of no duty to defend, there was good cause to refuse a defense. Similarly, in an earlier Third Circuit case, Pizzini v. Am. Int'l Specialty Lines Ins. Co., No. 03-1959, 107 Fed. Appx. 266, 2004 U.S. App. LEXIS 14246 (3d Cir. Jul. 12, 2004), the court stated: "Finally, appellants argue that even though the District Court held their assigned policy claims invalid, a statutory bad faith claim should not be precluded. We do not agree. Having already found that appellants can enforce no right under either policy, they lack the predicate action needed to pursue a 42 P.S. § 8371 bad faith claim ... This being the case, appellants' bad faith claim is not sustainable."¹ The Court relied on its earlier decision in PolSELLI v. Nationwide Mut. Fire Ins. Co., 126 F.3d 524, 530 (3d Cir. 1997) to support that conclusion. In a later case, USX Corp. v. Liberty Mutual Insurance Company, 444 F.3d 192 (3d Cir. 2006), cert. denied, 127 S. Ct. 296 (2006), after determining that there was no coverage, the Third Circuit rejected the bad faith claim, citing Frog Switch for the proposition that "bad faith claims cannot survive a determination that there was no duty to defend, because the court's determination that there was no potential coverage means that the insurer had good cause to refuse to defend." While recognizing that the duty to defend may be broader than the duty to indemnify, such a duty ends when the insurer can confine the claim to recoveries outside the scope of the insurance coverage.

Other cases cite the general principle, outside of that context. Rutkowski v. Allstate Ins. Co., 69 Pa. D.&C. 4th 10, 12 n.1 (C.C.P. Lackawanna 2004) (“Since the success of a bad faith claim is not dependent upon the resolution of the underlying contract claim ... a plaintiff may succeed on a bad faith claim even if she is unsuccessful with the underlying contract claim.”) A bad faith trial may proceed regardless of the outcome or existence of a contract claim. See Frederick & Emily's Inc. v. Westfield Group, 2004 U.S. Dist. LEXIS 17274 (E.D. Pa. 2004). In Monarch, Inc. v. St. Paul Prop. and Liab. Ins. Co., No. 03-CV-0054, 2004 U.S. Dist LEXIS 14803 (E.D. Pa. July 30, 2004), the Court stated that “[b]ad faith may exist even if no breach of contract occurred.”

In Shadduck v. Christopher J. Kaclik, Inc., 713 A.2d 635, 638 (Pa. Super. 1998), the Superior Court analyzed Nealy v. State Farm Mut. Auto. Ins., 695 A.2d 790, 793-94 (Pa. Super. 1997), appeal denied, 553 Pa. 690, 717 A.2d 1028 (1998). A case cited for the proposition that the underlying breach of insurance contract claim and the bad faith claim are two separate and independent causes of action. In Nealy, the Superior Court had ruled that the section 8371 claim was distinct from the breach of contract claim, and could not be arbitrated since it had a statutory basis requiring adjudication by a judge. The Superior Court in Shadduck explained: “A § 8371 bad faith claim, however, is initiated based upon behavior of the insurance company occurring subsequent to the negligent or intentional behavior of a third party that spawned the contractual suit. Thus, because *the behavior complained of is temporally and factually distinct* from any behavior that would impact upon the outcome of the damages and liability disposition of the contract claim, we see no reason to expand upon the panels’ jurisdiction.” Id. at 794 (emphasis added [by Superior Court]).

D. POST-TOY CASE LAW

1. The Impact of Gallatin Fuels

In Gallatin Fuels, Inc. v. Westchester Fire Insurance Co., 2007 U.S. App. LEXIS 19069 (3d Cir. Aug. 9, 2007), the Third Circuit affirmed a bad faith finding even absent a contractual duty, and even absent any insurance policy being in effect at the time of the putative claim, distinguishing Frog Switch. The Court stated its decision was “exceedingly rare”. Further, it was decided three weeks *after Toy*, but the Panel did not cite to that Pennsylvania Supreme Court decision in reaching its own conclusion in this rare circumstance. Despite the foregoing, this non-precedential Opinion has found a home in numerous opinions at the trial and appellate levels.

Gallatin Fuels recognized the principles that “failure to provide coverage cannot be bad faith where there is no duty to provide coverage” and that “it is certainly true that it is reasonable as a matter of law for an insurer to deny a claim on a certain ground where the policy precludes coverage on that ground....” The insurer had argued that it denied the insured’s claim because the policy had been cancelled at the time of the incident and, in the alternative, even if it had not been cancelled the insurer acted reasonably in handling the claim. The Court found, however, that even though there was no breach of the insurance policy because the policy had in fact been cancelled before the loss, the insurer had not asserted the cancellation of the policy as a reason for the denial for more than six months, misrepresented the terms of the policy, dragged its feet in the investigation of the claim, hid information from the insured, and continued to shift its basis

for denial of the claim. The Court concluded that because the parties believed that a policy existed when the claim was filed, and acted accordingly, even though the policy had been cancelled the insurer still acted in bad faith for denying the claim.

In distinguishing Frog Switch, precedent, the Court found that the Bad Faith Statute could apply to actions beyond denying coverage, which was the only basis of the bad faith claim in Frog Switch. Thus, the Gallatin Fuels Panel observed that the bad faith claim before it was “based largely on behavior *beyond* Westchester's denial of the claim.” (Emphasis added). This included the aforementioned misrepresenting policy terms, foot dragging claim investigation, hiding information from the insured, and altering its theories for denying the claims. “Thus, unlike in Frog, Switch & Manufacturing Co., a finding that the insured did not ultimately have a duty to cover the plaintiff's claim does not per se make the insured's actions reasonable. See 193 F.3d at 751 n.9 (‘Bad faith is a frivolous or unfounded refusal to pay, *lack of investigation into the facts, or a failure to communicate with the insured.*’ (emphasis added [by court])).”

A second distinction with Frog Switch was that the insurer had not asserted the policy cancellation as a basis to deny coverage until well after the insured first attempted to make his claim. “As such, it would be odd to allow an insurer to assert its good faith by pointing to a defense to coverage that it did not even use for a large part of the relevant time period.” The Court also cited Willow Inn, Inc. v. Pub. Serv. Mut. Ins. Co., 399 F.3d 224, 235 (3d Cir. 2004) to support its decision, stating that “[s]ection 8371 allows punitive damages awards even in the absence of other successful claims brought by the plaintiff.” Thus, Gallatin Fuels was “one of the exceedingly rare cases in which an insurer can be liable for bad faith even after the insured cancels the policy[,]” fundamentally because both parties had believed there was a policy, and in that context the carrier acted improperly.

The Court also cited the Superior Court's 1994 March decision for the proposition that: “‘Indeed, [a]s 42 Pa.C.S. § 8371 was promulgated to provide additional relief to insureds and to discourage bad faith practices of insurance companies, we would be reluctant to impose any limitations of claims brought under section 8371 which do not appear in the plain language of the statute.’” Such a broad conclusion appears to run directly contrary to the limitations expressly set forth by the Toy Majority as to the scope of cognizable claims under the Bad Faith Statute, reiterated a few months later in Ash.

Just a few months later, in Still v. Great Northern Insurance Company, No. 07-2425, 2007 U.S. App. LEXIS 26024 (3d Cir. November 7, 2007), another non-precedential Third Circuit Panel upheld the district court's grant of summary judgment to the carrier on the basis that the claim was not covered under the business pursuits exclusion. The Court stated that the bad faith “claim necessarily fails in the face of a determination that the insurer correctly concluded that there was no potential coverage under the policy.” And only a few weeks after Gallatin Fuels, an Eastern District Judge, citing Frog Switch, found the bad faith claim also failed because there was no duty to defend. “[B]ad faith claims cannot survive a determination that there was no duty to defend, because the court's determination that there was no potential coverage means that the insurer had good cause to refuse to defend.” Prudential Property & Casualty Insurance Co. v. Boyle, 2007 U.S. Dist. LEXIS 63690 (E.D. Pa. Aug. 29, 2007) (Kelly, J.), aff'd, 305 Fed. Appx. 35; 2008 U.S. App. LEXIS 26984 (Dec. 31, 2008).

Yet, since 2007, the Gallatin Fuels decision has been cited numerous times to support, or reference, the proposition that an absence of coverage does not preclude a potential bad faith claim for some form of conduct going beyond a denial of coverage.

In a later appellate case, Post v. St. Paul Travelers Ins. Co., 691 F.3d 500 (3d Cir. July 31, 2012), the insurer had a reasonable basis to decline coverage which foreclosed what the Court described as the insured's "primary bad faith argument." However, the insured asserted other distinct bad faith arguments concerning claims handling, e.g., "ignoring communications from the insured" and "violating its own policies and procedures". The insured principally relied upon Gallatin Fuels for the "proposition that 'a finding that the insure[r] did not ultimately have a duty to cover the plaintiff's claim does not per se make the insure[r]'s actions reasonable.'" The Post Court stated: "While that statement is no doubt true, [the insured]'s reliance on Gallatin Fuels is misplaced."

Thus, the Post Court accepted the possibility of an independent bad faith claim based solely upon claims handling, but rejected application of Gallatin Fuels in that case because that conduct "must import a dishonest purpose", and the absence of a reasonable basis to deny coverage. It explained that in Gallatin Fuels, both the insured and insurer believed the policy was in effect, but before realizing this was not the case, the insurer had "misrepresented the terms of the policy, dragged its feet in the investigation of the claim, hid information from [the insured], and continued to shift its basis for denying the claims.'" Thus, the Gallatin Fuels Court allowed that a jury could find bad faith giving the insurer's working assumption that the policy was in effect during the period of the dishonest conduct. The Post Court reiterated the earlier Court's statement that this was not only a rare holding, but "was 'one of the exceedingly rare cases in which an insurer can be liable for bad faith' even though there was no duty to provide coverage." Gallatin Fuels had no application to the facts in Post. Toy is not cited or analyzed in the Post Opinion.

A few months earlier, the Third Circuit had also made brief mention of this principle without citing Gallatin Fuels or going beyond simple dicta. Treadways LLC v. Travelers Indem. Co., 467 Fed. Appx. 143, 2012 U.S. App. LEXIS 5094 (3d Cir. March 12, 2012). That Opinion made the single generic statement, citing J.C. Penney Life Ins. Co. v. Pilosi, 393 F.3d 356, 367 (3d Cir. 2004) and Frog Switch: "Though we have found that bad faith may be found in circumstances other than an insurer's refusal to pay, '[a] reasonable basis is all that is required to defeat a claim of bad faith.'" That Court ruled that because the claims were not covered under the insurance policies at issue, the insurer "had good cause to deny coverage and cease defending the litigation." It added that there was no need to reach the issues of evidence on intent or recklessness.

In Muckelman v. Companion Life Ins. Co., 2014 U.S. Dist. LEXIS 32868 (M.D. Pa. Jan. 15, 2014) (Brann, M.J.), report and recommendation adopted in, Muckelman v. Companion Life Ins. Co., 2014 U.S. Dist. LEXIS 31960 (M.D. Pa., Mar. 12, 2014) (Schwab, J.), the Court stated in its recital of bad faith principles: "Though we have found that bad faith may be found in circumstances other than an insurer's refusal to pay, '[a] reasonable basis is all that is required to defeat a claim of bad faith.'" It cited a 2006 Superior Court opinion for the general proposition that bad faith claims are fact specific, and then stated as a predicate assumption that "since the

statute is not limited to an insurer's bad faith in denying a claim" plaintiffs may also find success in bad faith actions by asserting claims based on investigation, failures of communication with the insured, and delay. Almost all authority cited is pre-Toy; but Gallatin Fuels is cited for the proposition that: "insurer found liable for bad faith absent duty of coverage on grounds that it 'dragged its feet in the investigation of the claim, hid information from the insured, and continued to shift its basis for denying the claims.'" The only reference to Toy is a quote that section 8371 bad faith concerns: "the duty of good faith and fair dealing in the parties' contract and the manner in which an insurer discharged ... its obligation to pay for a loss in the first party claim context." There is no reference to the "exceedingly rare" nature of the Gallatin Fuels decision.

In Bank of Am., N.A. v. Martin, No. 1:12-cv-544, 2013 U.S. Dist. LEXIS 130381 (M.D. Pa. Sept. 12, 2013) (Conner, J.), the Court stated that the bad faith inquiry did not end because there was as yet no covered loss "because the absence of a duty to provide benefits does not per se render the insurer's denial reasonable." The court cited Willow Inn for the proposition that a punitive damage award was permitted "even in the absence of other successful claims brought by the plaintiff"; but cautioned, citing Post and Gallatin Fuels, "that cases in which an insurer may be liable for bad faith even though there was no duty to provide coverage are 'exceedingly rare.'" In that case, however, there was no bad faith because there was "no suggestion whatsoever that [the insurer]'s handling of the claim was egregious." Thus, although the Court found the plaintiff failed to make out a case for bad faith solely on the basis of claims handling, absent any coverage duty, it still recognized the possibility. Toy was not discussed in this context.

In National Fire Ins. Co. v. Robinson Fans Holdings, Inc., No. 10-1054, 2013 U.S. Dist. LEXIS 97226 (W.D. Pa. July 12, 2013) (Ambrose, J.), the Court generally cited Gallatin Fuels for the proposition: "[A] finding that the insure[r] d[oes] not ultimately have a duty to cover the plaintiff's claim does not per se make the insure[r]'s actions reasonable." In that case, the carriers had attempted to validate their conduct by events before and after the alleged bad faith conduct. Among other things they asserted that later events established the applicability of policy exclusions or absence of an occurrence, thus "post-hoc sustaining their earlier basis for denying a defense." The Court stated: "Even assuming that their arguments were borne out by evidence in the underlying trial, my [prior] conclusion that the Complaint possibly pleaded such an event is not thereby expunged. As of the time of my decisions issued in this litigation, the claim had not been confined to an ineligible one. Whether the facts eventually ripened at some point into reasonable support for Plaintiffs' position is not dispositive of reasonableness at all pertinent times; certainly, what is reasonable at one juncture might well be unreasonable at another, depending on surrounding circumstances."

In Gold v. State Farm Fire & Cas. Co., 880 F. Supp. 2d 587 (E.D. Pa. July 24, 2012) (McLaughlin, J.), the Court cited Gallatin Fuels for the proposition that "if bad faith is asserted as to conduct beyond a denial of coverage, the bad faith claim is actionable as to that conduct regardless of whether the contract claim survives," along with three federal district court cases. Among these were a pre-Toy case from 1996, and two post-Toy cases: Rohm & Haas Co. v. Utica Mut. Ins. Co., No. 07-584, 2008 U.S. Dist. LEXIS 48077 (E.D. Pa. June 23, 2008) (Pratter, J.) for the proposition that "at motion to dismiss stage, 'there is at least the possibility that [the plaintiff]'s bad faith claim could exist independent of its duty to defend claim"; and Moss Signs,

Inc. v. State Auto. Mut. Ins. Co., No. 08-164, 2008 U.S. Dist. LEXIS 26770 (W.D. Pa. Apr. 2, 2008) (Standish, J) for the proposition that “because bad faith was alleged in investigation and in denial of coverage, the plaintiff could ‘theoretically succeed on either or both’ of the claims.”

Rohm & Haas cited the Third Circuit’s 2005 decision in Northwestern Mut. Life Ins. Co. v. Babayan, 430 F.3d 121 (3d Cir. 2005), which had stated that: “Courts have extended the concept of “bad faith” beyond an insured’s denial of a claim in several limited areas. See W.V. Realty, Inc. v. Northern Ins. Co., 334 F.3d 306, 317-18 (3d Cir. 2003) (insurer’s failure to follow internal guidelines evidence of bad faith); Bonenberger v. Nationwide Mut. Ins. Co., 2002 PA Super 14, 791 A.2d 378, 381 (Pa. Super. Ct. 2002) (insurer’s claims practice manual is relevant evidence in bad faith claim against insurer); O’Donnell ex rel. Mitro v. Allstate Ins., 1999 PA Super 161, 734 A.2d 901 (Pa. Super. Ct. 1999) (bad faith may extend to the misconduct of an insured during the pendency of litigation); Liberty Mut. Ins. Co. v. Marty’s Express, Inc., 910 F. Supp. 221 (E.D. Pa. 1996) (bad faith may extend to an insurer’s conduct in retrospectively rating and collecting premiums).” Rohm & Haas cited precedents where bad faith could be separated from the issue of coverage if the underlying insurance contract dispute had settled or was barred because of the statute of limitations; but it also cited Gallatin Fuels and the Gallatin Fuels line of cases, which included Moss Signs, as the most pertinent precedent to the bad faith claims before it. Neither Rohm & Haas nor Moss Signs, both post-Toy cases which rely heavily on Gallatin Fuels, address Toy or cite to it.

In Yellowbird Bus Co. v. Lexington Ins. Co., NO. 09-58352010 U.S. Dist. LEXIS 69554 (E.D. Pa. July 13, 2010), aff’d, 450 Fed. Appx. 213, 2011 U.S. App. LEXIS 22574 (3d Cir. Nov. 8, 2011), the Court generally recognized that “where an insurer has no duty to indemnify under the insurance policy, a claim for bad faith must be dismissed.” However, it also stated: “In certain limited circumstances, the Third Circuit has recognized the concept of ‘bad faith’ can extend beyond an insured’s denial of a claim to several other areas of misconduct.” It cited Babayan, W. V. Realty, and Gallatin Fuels. In Excelsior Ins. Co. v. Incredibly Edible Delites, 2009 U.S. Dist. LEXIS 118247 (E.D. Pa. Dec. 19, 2009) (O’Neill, J.), addressing bifurcation of claims, the Court cited Gallatin Fuels stating that “the Court of Appeals allowed the insured’s bad faith claim to proceed even assuming the insurer was correct as a matter of law in denying the claim because ‘the bad faith claim [was] based largely on behavior beyond [the insurer’s] denial of the claim.’” It cited to Gallatin Fuels identification of such claims: “misrepresented the terms of the policy, dragged its feet in the investigation of the claim, hid information from [the insured], and continued to shift its basis for denying the claims.” The court then stated: “Similarly, a finding here that [the insurer] did not ultimately have a duty to cover ... does not make [its] alleged actions (e.g., wrongfully naming ... a defendant in this action and thereby disrupting ... settlement proceedings [in other] litigation) per se reasonable.”

2. Non-Gallatin Fuels Case Law Expanding Bad Faith Claims

There is post-Toy case law reaching the same conclusion stated in Gallatin Fuels, going beyond the contexts of technically barred or settled claims, which does not cite Gallatin Fuels; but sometimes considers Pennsylvania Superior Court precedent.

In Mountainside Holdings, LLC v. Am. Dynasty Surplus Lines Ins. Co., No. 2003-127, 2014 Pa. Dist. & Cnty. Dec. LEXIS 73 (C.C.P. Centre County June 30, 2014) (Grine, J.), the

Court relied upon Superior Court precedent in stating that: “Section 8371 is not restricted to an insurer's bad faith in denying a claim. An action for bad faith may extend to the insurer's investigative practices. Bad faith conduct also includes lack of good faith investigation into facts, and failure to communicate with the claimant.” It cited Grossi Travelers Personal Ins. Co., 2013 79 A.3d 1141, at 1149 (Pa. Super. Ct. 2013). Grossi itself looked to Condio v. Erie Ins. Exch., 899 A.2d 1136, 1142-1143 (Pa. Super. Ct. 2006) for the proposition that “section 8371 is not restricted to an insurer's bad faith in denying a claim. An action for bad faith may extend to the insurer's investigative practices. Bad faith conduct also includes lack of good faith investigation into facts, and failure to communicate with the claimant.” As set forth above, however, the Toy Majority cited Condio as an example of a case where the issue was what kind of bad faith conduct constitutes sufficient evidence, and it was not a case whether the conduct at issue formed the basis of a cognizable bad faith claim. Thus, in 2007, the Supreme Court had rejected the idea that the type of conduct addressed in Condio formed the basis of a cognizable bad faith claim. Grossi does not address this issue, nor does it cite to Toy.

In Calandrello v. Sentinel Ins. Co., NO. 3:13-CV-134, 2013 U.S. Dist. LEXIS 79967 (M.D. Pa. June 7, 2013) (Conaboy, J.) and Fabrikant v. State Farm Fire & Cas. Co., No. 3:11-CV-438 2012 U.S. Dist. LEXIS 67017 (M.D. Pa. May 14, 2012) (Conaboy, J.), the Court likewise cited Condio and other pre-Toy Superior Court case law. The Court cited O'Donnell ex. rel. Mitro v. Allstate Ins. Co., 734 A.2d 901 (Pa. Super. 1999), where “the Pennsylvania Superior Court discussed the expanding nature of the applicability of the bad faith statute and held that the conduct of an insurer during the pendency of litigation may be considered as evidence of bad faith.” The Court stated that: “Bad faith is not restricted to an insurer's denial of benefits and includes a wide variety of objectionable conduct including lack of good faith investigation and failure to communicate with a client.” It cited Brown v. Progressive Ins. Co., 860 A.2d 493, 500-01 (Pa. Super. Ct. 2004) as listing examples of such cases. Like Condio, however, Brown and O'Donnell were cases specifically cited by Toy as addressing conduct that was evidentiary in nature, not conduct on which a cognizable bad faith claim could be based.

The Fabrikant decision also cites Berg v. Nationwide Mutual Ins. Co. 44 A.3d 1164 (Pa. Super. Ct. 2012), appeal denied, 65 A.3d 412 (2013). In Berg, the insureds sought “bad faith damages under section 8371 ... based upon [the insurer’s] alleged breach of its contractual duties as contained in the ... insurance policy, including the duties of good faith and fair dealing. ... [and that] the [insureds] allege that subsequent to an accident, they contacted [the insurer] to assert a claim for prompt payment under their policy, and that [the insurer] acted in bad faith in not effectuating ‘the prompt, fair and equitable settlement of [the insureds'] claim where [the insurer's] statutory and contractual duty to do so is reasonably clear.’” The Bergs had taken their car in for repairs, which were done in a faulty manner through the insurer’s repair program, and allegedly involved into a series of dangerous misrepresentations concerning the condition of their car. There appears to be no question in Berg that the insurer owed some coverage obligation to the insured. Nor is there any conclusion that the insurer did not in fact owe a coverage duty under the policy, but was still subject to bad faith solely for the manner in which the insured handled the first party claim absent any coverage obligation.

Rather, Berg’s focus is on the allegedly malevolent conduct during the process of the insurer’s repairing the insureds’ car, and the apparently abundant evidence of misdeeds during

that process. Berg cites Toy for the principle that “our Supreme Court recently reaffirmed that the term ‘bad faith’ under section 8371 concerns ‘the duty of good faith and fair dealing in the parties’ contract and the manner in which an insurer discharged ... its obligation to pay for a loss in the first party claim context.” Immediately after citing that proposition, Berg gives examples of the evidence used by the Bergs at trial to make out their bad faith case.

Thereafter in rejecting the Trial’s Court’s 1925(b) statement that the insureds failed to establish a denial of benefits, apparently on the basis that the insurer had taken some steps to fix the car, the Superior Court stated: “[T]he trial court's focus on the alleged lack of denial of benefits [is] confusing in light of the test of section 8371, which sets forth no such requirement to be entitled to damages for the insurer's bad faith. To the contrary, the focus in section 8371 claims cannot be on whether the insurer *ultimately* fulfilled its policy obligations, since if that were the case then insurers could act in bad faith throughout the entire pendency of the claim process, but avoid any liability under section 8371 by paying the claim at the end. As our Supreme Court in *Toy* explained, the issue in connection with section 8371 claims is the *manner* in which insurers discharge their duties of good faith and fair dealing during the pendency of the insurance claim, not whether the claim is eventually paid. *Toy*, 593 Pa. at 41, 928 A.2d at 199. For purposes of [the insureds’] section 8371 claim, whether [the insurer] ultimately paid the benefits due under the policy is not the relevant inquiry; instead the dispute is whether [the insurer] acted in bad faith in its dealings with the [insureds].”

Berg’s page citation to Toy includes the language: “It was against this backdrop that the General Assembly enacted § 8371 in 1990. It is evident that by this time, the term ‘bad faith’ as it concerned allegations made by an insured against his insurer, had acquired a particular meaning in the law. That is, the term ‘bad faith’ concerned the duty of good faith and fair dealing in the parties’ contract and the manner by which an insurer discharged its obligations of defense and indemnification in the third-party claim context or its obligation to pay for a loss in the first party claim context. See, e.g., Cowden, 134 A.2d at 223; D’Ambrosio, 431 A.2d at 966. See also Black’s Law Dictionary 139 (6th ed. 1990). (““Bad Faith” on the part of an insurer is any frivolous or unfounded refusal to pay proceeds of policy....”) In other words, the term captured those actions an insurer took when called upon to perform its contractual obligations of defense and indemnification or payment of a loss that failed to satisfy the duty of good faith and fair dealing implied in the parties’ insurance contract.” This page in Toy also includes footnote 16, discussed at length above, addressing the limited the scope of cognizable bad faith claims vs. the broader consideration of conduct that may be used as evidence of bad faith, which is not in itself the origin of a cognizable bad faith claim.

In light of Berg’s factual setting, and the necessity that the Superior Court adhere to Supreme Court precedent, Berg cannot stand for the proposition that all manner of claims handling creates cognizable claims for Statutory Bad Faith where the insurer otherwise has no contractual duty to provide coverage (or a defense). Rather, the manner of claims handling can always be considered as evidence of bad faith in cases where the insurer delays benefits owed or denies them.

In Blackwell v. Allstate Ins. Co., NO. 14-878, 2014 U.S. Dist. LEXIS 123067 (E.D. Pa. September 3, 2014) (Rufe, J.), the court found that the contractual one year period for

bringing a claim under a homeowners policy barred the insureds' breach of contract claim; however, the statutory bad faith claim was not barred by that contractual term, nor, on the face of the complaint, was it barred by the applicable two year statute of limitations. Rather than involving a separate basis for bringing a bad faith claim in the absence of a coverage duty, this falls into the line of cases where the bad faith claim survives if the coverage claim fails for a technical, rather than substantive, reason. Similarly, in Condi v. State Farm Ins. Co., No. 3:13cv1100, 2013 U.S. Dist. LEXIS 120873 (M.D.Pa. August 26, 2013) (Munley, J.), the Court dismissed the breach of contract claim for failing to timely bring that claim, but allowed an otherwise viable bad faith claim to proceed.

In Davis v. Allstate Prop. & Cas. Co., No. 13-cv-07038, 2014 U.S. Dist. LEXIS 138022 (E.D. Pa. September 30, 2014) (Knoll Gardner, J.), the court ruled that "plaintiff's bad faith claim fails as a matter of law because a correct determination of coverage precludes a bad faith claim predicated on a theory that the insurer unreasonably denied coverage." However, it also stated that: "Plaintiff argues correctly that Pennsylvania law does not limit bad faith claims to unreasonable denials of coverage. A bad faith can have various other bases, including an insurer's lack of investigation, lack of adequate legal research concerning coverage, or failure to communicate with the insured." It cited a 1991 district court case for this proposition, along with Judge Gibson's 2012 decision in Smith v. Allstate Insurance Company, 904 F.Supp.2d 515 (W.D. Pa. 2012). The Court found that none of these "alternative bases" were pleaded, but gave the plaintiff leave to amend if they could be pleaded.

Smith relied on a number of pre and post-Toy cases to support the proposition that "Section 8371 encompasses a broad range of insurer conduct." One example was citation to the Trial Court opinion in Hollock, for the proposition that: "Bad faith also occurs when an insurance company makes an 'inadequate investigation or fails to perform adequate legal research concerning a coverage issue.'" Smith does not cite Toy. Although not addressing the same conduct, as set forth above, Justice Cappy had included Hollock in his explanation of the distinction between cognizable bad faith claims and bad faith conduct that may be used as evidence to support a cognizable claim. Thus, he states the issue presented in Hollock "was whether the conduct of the insurer during discovery and throughout the course of the trial on the insured's bad faith claim should have been considered for purposes of establishing liability and setting the amount of the punitive damages award. The issue was not, as here [in Toy], whether the claim the insured brought against the insurer fell within § 8371's purview, given the meaning of the statutory term 'bad faith.' 42 Pa.C.S. § 8371." Under the Toy analysis, Smith's citation to Hollock is merely addressing evidentiary conduct that can support a cognizable bad faith claim, and not the scope of conduct itself for which there is a cognizable bad faith claim.

3. Recent Examples of Cases Where no Bad Faith if no Coverage Due

In White v. Metro. Direct Prop. & Cas. Ins. Co., NO. 13-434, 2014 U.S. Dist. LEXIS 102959 (E.D. Pa. July 29, 2014) (Buckwalter, J.), after finding no breach of contract, the court addressed the bad faith claim: "The current bad faith claim before the Court cannot get past the initial element—lack of a reasonable basis for denying benefits. As explained in detail above, Defendant's denial of benefits was not only reasonable, but correct under the Policy language. Absent a showing of an unreasonable denial, Plaintiffs are not entitled to recover on their bad faith claim."

In Allegheny Design Mgmt. v. Travelers Indem. Co. of Am., No. 2:12-cv-00658-TFM, 2013 U.S. Dist. LEXIS 137748 (W.D. Pa. Sept. 25, 2013) (McVerry, J.), the Trial Court found there was no coverage under the definition of “occurrence” and/or policy exclusions, and concluded: “Where, as here, there is no coverage under an insurance policy, an insurer cannot be found to have acted in bad faith for denying coverage.” On appeal, Allegheny Design Mgmt. v. Travelers Indem. Co. of Am., No. 13-4263, 2014 U.S. App. LEXIS 13190 (3d Cir. July 11, 2014), the Third Circuit affirmed, finding that there was no bad faith because the carrier “had a reasonable basis for denying coverage ... based upon the ‘occurrence’ definition and the Exclusions referred to above.”

In AmerisourceBergen Corp. v. ACE Am. Ins. Comp., March Term 2011, No. 02679, 2013 Phila. Ct. Com. Pl. LEXIS 249 (C.C.P. Phila. Jul 16, 2013) (Snite, Jr., J.), citing Frog Switch, the Court found that “[b]ecause this court has determined that an exclusion applies, this [bad faith denial of coverage] claim failed.”

In Advertis Inc. v. Peerless Indem. Ins. Co., No. 12-1352, 2013 U.S. Dist. LEXIS 123450 (E.D. Pa. August 29, 2013) (Goldberg, J.), the Court stated: “For the foregoing reasons, we find that the plain language of the insurance policy purchased by Plaintiff from Peerless does not cover the loss that occurred at Plaintiff’s warehouse in September 2011, and that Plaintiff’s breach of contract and bad faith claims fail as a matter of law.”

In Certain Underwriters at Lloyd’s London Subscribing to Policy No. SMP3791 v. Creagh, No. 12-571, 2013 U.S. Dist. LEXIS 89346 (E.D. Pa. June 25, 2013) (DuBois, J.), the Court found that the exclusion the insurer relied upon did in fact preclude coverage, and thus its reliance on the exclusion “to deny insurance coverage was not in bad faith, and there is no genuine dispute of material fact on this question.”

In Hackbarth v. Nationwide Mut. Ins. Co., Civil No. 13-1596, 2014 U.S. Dist. LEXIS 92971 (W.D. Pa. July 8, 2014) (Cohill, J.), there was no coverage due and the breach of insurance contract claim was dismissed. As to the insured’s bad faith claim, while the Court seemed on the verge of wrestling with the argument that there could be bad faith in the absence of any duty to provide benefits, the insured ultimately conceded that if there was no breach of contract, there could be no bad faith. Even had the Court ruled for the insured on the contract claim, it would still have dismissed the bad faith claim “because Plaintiff’s Complaint fails to aver sufficient facts which allow for drawing a reasonable inference that Defendant acted in bad faith when denying coverage under the Policy.”

In Focht v. State Farm Fire & Cas. Co., No. 3:12-CV-01199, 2014 U.S. Dist. LEXIS 124561 (M.D. Pa. September 5, 2014) (Mariani, J.), the Court observed that Terletsky’s reasonableness prong has been generally subject to an objective reasonableness standard since Williams v. Hartford Cas. Ins. Co., 83 F. Supp. 2d 567 (E.D. Pa. 2000), and that as long as “there is a reasonable basis for delaying resolution of a claim, even if it is clear that the insurer did not rely on that reason, there cannot, as a matter of law be bad faith.” (Emphasis added) Judge Mariani did note, however, the comment in Shannon v. New York Cent. Mut. Ins. Co., 2013 U.S. Dist. LEXIS 165280 (M.D. Pa. 2013) (Conaboy, J.) that: “Given the remedial purpose underpinning the Bad Faith Statute, we are not persuaded that permitting an insurer to evade its statutory obligation due to some fortuitous fact to which it was oblivious is consistent with the

legislature's intent." This was in response to the insurer's argument that "if there is a reasonable basis for delaying resolution of a claim, even if it is clear that the insured did not rely on that reason, there cannot, as a matter of law, be bad faith...." A few months earlier in Bodnar v. Amco Ins. Co., 3:12-CV-01337, 2014 U.S. Dist. LEXIS 94931 (M.D. Pa. July 11, 2014), Judge Mariani had raised the point about Terletsky's reasonableness prong being evaluated objectively or subjectively, but cited Williams and observed that, with only slight dissent, this reasoning has been almost universally followed over the ensuing 14½ years by Pennsylvania's District Courts. Still, the Court was not faced with the issue of deciding whether it needed to apply Williams, and thus would not say at this time that it was controlling law.