IN THE COURT OF COMMON PLEAS OF PHILADELPHIA COUNTY
FIRST JUDICIAL DISTRICT OF PENNSYLVANIA

CIVIL TRIAL DIVISION

CORDISCO, BRADWAY & SIMMONS and DAVID J. SOWERBUTTS, ESQUIRE	:	
Plaintiffs,	:	
vs.		
	:	FEBRUAURY TERM, 2007
GULF INSURANCE GROUP		
and		
ATLANTIC INSURANCE COMPANY	:	NO. 00111
and		
ST. PAUL TRAVELERS	:	
and		
TARGET INSURANCE SERVICES	:	
and		
TARGET PROFESSIONAL ASSOCIATES	:	COMMERCE PROGRAM
and		
MARKS, O'NEIL, O'BRIEN & COURTNEY, PC.	:	
Defendants.	:	

MEMORANDUM OPINION

This dispute arises out of a legal malpractice insurance policy. On Feb. 5th 2007, Plaintiffs Cordisco, Bradway & Simmons ("Plaintiff / The Law Firm"), a law firm, and David Sowerbutts, a former employee, filed this action against Defendant Insurance Companies seeking damages for Breach of Contract, Breach of Fiduciary Duty, Bad Faith, Negligent Misrepresentation and "Estoppel / Detrimental Reliance."[1] Defendants Counterclaim seeking a declaration that the Insurance Policy is rescinded or alternatively, that it does not provide coverage. Presently, before the court is Defendant's Motion for Judgment on the Pleadings. The pleadings include Plaintiff's Second Amended Complaint, which includes eleven exhibits, Defendants Answer with New Matter and Plaintiffs reply thereto.

[1] Defendants in this suit are Gulf Insurance Group, Atlantic Insurance Company, St. Paul Travelers, Target Insurance Services, Target Professional Associates (collectively "Defendants / Defendant Insurance Companies") and Marks, O'Neil, O'Brien & Courtney, PC. ("Defendant / Retained Law Firm").

In late 2001, Thomas Ulmer ("Ulmer") and Helen Graeser ("Graeser") retained Plaintiff Law Firm and attorney Sowerbutts to file a chapter 13 Bankruptcy petition to prevent the sale of their home. Attorney Sowerbutts did not file the petition. By April 10th 2002, the home was sold and the couple evicted. That same day, Ulmer and Grasier went to see Sowerbutts. When they saw him, he told them that "it's my fault… I passed your case on to one of my legal aides and I let your case slip through the cracks."[2] This negligence gave rise to suit ("Underlying Action").[3] Plaintiffs herein settled that case.[4] It is "the joint and several actions of Defendants in the handling of the claim, defense and indemnity" that forms the basis of this suit.[5] Plaintiffs remarkably concede that the policy does not provide coverage for the Underlying Action.[6] Their action centers on "Defendants' failure to timely and effectively investigate the claim in the Underlying Action," and their "failure to timely, promptly and effectively disclaim coverage."[7]

By Jan. 2003, Sowerbutts was no longer employed by the Law Firm. Later that year, the Law Firm purchased a claims-made professional liability insurance policy ("the policy") effective Aug. 18th 2003 to Aug. 19th 2004 from Defendants herein.[8] One of the questions on the policy application asked:

"Does any attorney for whom coverage is sought know of any incident, act, error or omission that could result in a claim or suit against the Firm or any current **or former members**?"

[2] Second Amended Complaint p.5 ¶ 27
[3] Thomas J. Ulmer and Helen Graeser v. David J. Sowerbutts, Esquire and Cordisco, Bradway & Simmons f/k/a Cordisco, Bradway, Simmons & Truelove, Philadelphia Court of Common Pleas, January Term 2004, No. 02309 (Exhibit B).
[4] Plaintiffs paid $153,000 in settlement fees and $47,000 in legal and expert fees. Second Amended Complaint p.15 ¶ 85-86. They demand judgment in the amount of $200,000 plus all fees and costs incurred in the instant case. *Id*. at p.18 ¶ 97.
[5] *Id*. at p.4 ¶ 21
[6] "Plaintiffs do not contest or dispute Defendants' decision to deny coverage or the basis on which Defendants have denied coverage". *Id*. at 16 ¶ 88
[7] *Id*. at 14 ¶ 73 and ¶ 79
[8] *Id*. at Exhibit A

Plaintiff Law Firm responded "No."[9] On Jan. 20th 2004, Ulmer and Grasier filed a complaint against Plaintiffs herein alleging malpractice in failing to file the Bankruptcy petition. The complaint was tendered to Defendants herein, who allegedly "accepted the claim" on Feb. 9th 2004.[10] Eleven days later, Defendant Target Professional Associated ("TPA") sent a reservation of rights letter in which it advised Plaintiff that indemnity and coverage may be denied:

"because all the alleged wrongful acts took place prior to the inception date of the policy. If it is determined that your office was aware of a claim prior to the inception date of this policy, we reserve the right to withdraw from coverage."[11]

On Aug. 20th 2004, Defendant Gulf Insurance Group ("Gulf") sent a Disclaimer Letter to Plaintiffs notifying that it will "neither indemnify nor defend the Insured in this matter." The letter advised Plaintiffs that they had "thirty days" to obtain new counsel or make arrangements to retain current counsel "solely at [their] cost and expense." The Disclaimer letter also warned that Defendant Insurance Companies "will instruct defense counsel to withdraw from the defense of this matter in 30 days unless" retained at Plaintiffs own cost.[12] The letter justified disclaimer on the grounds that: (1) Policy provision G excludes claims made prior to the inception date if the Insured had knowledge or foreseeability of the claim, and/or (2) "Material misrepresentations contained in an application can render a policy void from its inception."[13]

In response, Plaintiffs sent an Objection Letter to Defendant Gulf, in which Plaintiff informed Defendant that "at the time the policy application was made, Mr. Sowerbutts was no

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[9] Defendants Answer to Plaintiffs Second Amended Complaint, Exhibit 1 p. 6.
[10] The complaint alleges that TPA "accepted the claim on behalf of itself and Defendants Gulf, Atlantic, St. Paul and Target Insurance Services by letter dated Feb. 9, 2004… which is attached as Exhibit 'C'". Thereafter, Defendants "retained the law firm of [Defendant] Marks, O'Neil, O'Brien & Courtney, P.C. to represent Plaintiffs in the Underlying Action." Second Amended Complaint, p.6 ¶ 29 – 30.
[11] Letter dated Feb. 20th 2004. *Id*. at Exhibit D
[12] *Id*. at Exhibit F
[13] *Id*.

longer employed at" the Law Firm and that "therefore, the application was answered correctly." The Objection Letter alleged that no claim had been received in the Underlying Action until Plaintiffs were served on Jan. 20th 2004 (within the policies effective dates), and that the insurer had been "immediately notified" thereafter.[14] In response, Plaintiff Law Firm received an Opinion Letter from lawyers representing the Insurance Companies in which disclaimer of indemnity and coverage was confirmed and explained.[15]

Thereafter, Plaintiff Law Firm received a letter from the Law Firm, which had been retained by Defendant Insurance Companies and had been representing Plaintiffs in the Underlying Action. In that letter, retained counsel stated that he "believed [he] had authority to represent" plaintiffs on this matter but that he had been instructed by Defendant Insurance Companies to "cease and desist all activity on this file."[16] Subsequently, Defendant Law Firm filed a petition to withdraw as counsel.[17]

The final communication alleged in the complaint, is a letter between Defendant Atlantic Insurance Company ("Atlantic") and Defendant Law Firm. In this letter, Atlantic denies having ordered the Law Firm to "cease and desist all activity" in representing Plaintiffs. The letter says that Plaintiffs were given "thirty days to obtain new counsel or make arrangements with [the] firm to continue to defend them solely at [their] cost and expense." The letter concedes that "in light" of Plaintiffs "challenge to Atlantic's coverage position, Atlantic allowed additional time for [Plaintiffs] to make any necessary defense arrangements."[18]

The complaint alleges that "Defendants' admission that it never instructed [Defendant] Law Firm to withdraw is a direct violation of the Disclaimer Letter and their own instructions,

[14] *Id*. at Exhibit G
[15] *Id*. at Exhibit H
[16] *Id*. at Exhibit I
[17] *Id*. at Exhibit K
[18] *Id*. at Exhibit J

policies and procedures."[19] The complaint also alleges that (1) "Defendants continued participation in the defense… from Feb. 9th 2004 through Feb. 4th 2005,"[20] and (2) their "failure to timely, promptly and effectively disclaim coverage"[21] operates as a waiver, and estopps Defendant's from subsequently denying coverage. Plaintiffs allege detrimental reliance because they had relinquished management and defense of the case to Defendants.[22] Defendants respond that Plaintiffs were given "more than a reasonable time to acquire counsel," and that "having been told on two separate occasions that coverage was denied, and being told to obtain their own counsel, could not justifiably rely that Defendants would provide a continued defense of the Underlying Action."[23]

The Policy

Plaintiffs purchased a claims-made insurance policy from Defendants. Section VII of the policy defines "claim" as:

> "a demand received by an insured for money or services alleging an error, omission, negligent act or 'personal injury' in rendering of or failure to render 'professional legal services' for others by you or on your behalf."[24]

Section II defines "Insured" as:

A. The "Named Insured" shown in the Declarations; and
B. Any person who was, is now or hereafter becomes a… employee… of any of the foregoing, whether named or not, but only while acting in the scope of his duties as such…

The policy "Declaration" names Plaintiff Law Firm (Cordisco, Bradway & Simmons) as the "Named Insured".[25]

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[19] *Id*. at p.10 ¶ 53
[20] *Id.* at ¶ 61
[21] *Id*. at ¶ 62
[22] Plaintiffs allege that "as a direct and proximate result of Defendants' misrepresentations, Plaintiffs herein were prejudiced in their defense of the Underlying Action. *Id*. at ¶114-115.
[23] Defendant's Motion for Judgment on the Pleadings, p.15 ¶51
[24] Second Amended Complaint, Exhibit A, p.4, Section VII B

Section VI defines policy exclusions and states that "insurance does not apply to "claims":

G. Arising out of any error, omission, negligent act or "personal injury" occurring prior to the inception date of this policy if any insured prior to the inception date knew or could have reasonably foreseen that such error, omission, negligent act or "personal injury" might be expected to be the basis of a "claim"".[26]

Finally, Section VIII defines "Conditions" and states that:

M. By accepting this policy, you agree:

1. The statements in the application which is attached hereto and forms a part of the policy are accurate and complete; and
2. We have issued this policy in reliance upon you representations.[27]

Legal Discussion

Defendants have filed a Motion for Judgment on the Pleadings. Entry of Judgment on the Pleadings is permitted under Pa. R. Civ. P. 1034. A Motion for Judgment on the Pleadings may be granted only where the pleadings demonstrate that no genuine issue of fact exists and the moving party is entitled to judgment as a matter of law.[28] The court must confine its consideration to the pleadings and relevant documents. It must accept as true all well pled statements of fact, admissions, and any documents properly attached to the pleadings presented by the party against whom the motion is filed, considering only those facts which were specifically admitted.[29] Finally, granting a motion for judgment on the pleadings may be appropriate in cases which turn upon the construction of a written agreement.[30]

The pleadings herein are now closed and this court may properly consider Defendants' Motion for Judgment on the Pleadings.

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[25] *Id*. at p.2, Section II A - B
[26] *Id*. at p.3, Section VI. The Policy effective dates were from Aug. 19th 2003 to Aug. 19th 2004.
[27] *Id*. at p.7, Section VIII M
[28] Wilcha v. Nationwide Mut. Fire Ins. Co., 887 A.2d 1254, 1258 (Pa. Super. Ct. 2005)
[29] Conrad v. Bundy, 777 A.2d 108, 110 (Pa.Super. 2001)
[30] Gallo v. J.C. Penney Cas. Ins. Co., 476 A.2d 1322, 328 (Pa. Super. 1984)

Counts I and III of the complaint allege Breach of Contract and Breach of Fiduciary Duty. For the reasons below, Motion for Judgment on the Pleadings is granted.

There was no breach of contract or breach of fiduciary duty because the claim was excluded from coverage; and material misrepresentation rendered the contract void from its inception

(1) There was no breach of contract or breach of fiduciary duty because the claim was excluded from coverage

The principles of insurance contract interpretation are well settled. Interpretation of an insurance contract is a question of law.[31] While ambiguities in an insurance contract will be resolved in favor of the insured, the court is required to give effect to clear and unambiguous language.[32] If the language is clearly worded, plain and free of ambiguity, it will be given full effect.[33] The insurer's duty to indemnify its insured arises only if it is established that the claimant's damages are within policy coverage.[34] Like the duty to indemnify and defend, fiduciary duties of good faith and due care arise only when the policy is in force. Under a "Claims-made" policy, only claims made during the policy period are covered.[35]

Under a typical liability insurance contract, an insurer undertakes three distinct types of obligations: an insurer agrees to indemnify and defend the insured against any suits arising under the policy. The insurer also assumes a fiduciary responsibility to the insured and becomes obligated to act in good faith and with due care.[36] However, these obligations arise only if the insured can show that the policy was in force on the day in question.[37] An insurer's duties arise

[31] Kvaerner, 908 A.2d 897
[32] Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co., 908 A.2d 888, 893 (2006); Donegal Mut. Ins. Co. v. Baumhammers, 938, A.2d 286, 290 (Pa. 2007)
[33] Standard Venetian Blind Co. v. American Empire Insurance, 503 Pa. 305, 469 A.2d 563 (1983)
[34] Donegal Mut. Ins. Co. v. Baumhammers, 938, A.2d 286, 291 (Pa. 2007) citing Mutual Benefit Ins. Co. v. Haver, 555 Pa. 534, 538, 725 A.2d 743, 745 (1999)
[35] Employers Reinsurance Corp. v. Sarris, 746 F. Supp. 560 (E.D. Pa. 1990)
[36] Gedeon v. State Farms Mut. Auto. Ins. Co., 188 A.2d 320 (Pa. 1963)
[37] *Id*. at FN2; Fullmer v. Farm Bureau Mut. Auto Ins. Co., 39 A.2d 623 (Pa. 1944) (An insurer has a duty to indemnify its insured only when the claim is actually within policy coverage).

"by reason of the insurance contract."[38] Conversely, if the insured cannot show that the policy was in force on the day in question, the insurer's obligations are not triggered. Fundamental principles of insurance law make it clear that, as a necessary prerequisite to recovery upon an insurance policy, the insured must show that the claim was within the coverage provided by the policy.[39]

In the present case, exclusion G was conspicuously displayed, clearly worded and free of ambiguity. It clearly excluded claims made prior to the inception date "if any insured… knew or could have reasonably foreseen" them.[40] The policy clearly defined "insured" to include former employees "acting in the scope of [their] duties,"[41] as is the case here. Such clear and unequivocal language must be given effect.

In Ehrgood v. Coregis Ins. Co.,[42] the Third Circuit Court of Pennsylvania was faced with a similar factual situation and the identical exclusionary language. Ehrgood involved an insured law firm which sought declaratory judgment that their insurer had a duty under a claims-made policy to defend them in a legal malpractice claim. The insurer counterclaimed and sought rescission based on the prior knowledge exclusion. Applying Pennsylvania law, the Court upheld the prior knowledge exclusion and reasoned that "where language of a contract is clear and unambiguous, [the] court is required to give effect to that language."[43] That court also reasoned that prior knowledge exclusions of a legal malpractice insurance policy must be applied

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[38] Dercoli v. Pennsylvania Nat. Mut. Ins. Co., 554 A.2d 474 (Pa. 1989) ("By reason of said insurance contract, Defendants were charged with a duty of good faith and fair dealing"). The Birth Ctr. v. St. Paul. Cos. Inc., 727 A.2d 1144 (Pa. Super. 1999) ("The obligation to act with the utmost good faith arises by virtue of the insurer's assumption in the insurance contract"). Gedeon v. State Farms Mut. Auto. Ins. Co., 188 A.2d 320, 322 (Pa. 1963) ("Our cases have held that the obligation to defend arises whenever the complaint filed by the injured party may *potentially* come within the coverage of the policy").
[39] Miller v. Boston Ins. Co., 420 Pa. 566, 218 A.2d 275 (1966)
[40] Second Amended Complaint, Exhibit A, The Policy, p.3 Section VI part G
[41] *Id*. at p.2 Section II part B
[42] 264 F. 3d 302 (3rd Cir. 2001)
[43] *Id*. at 442

whenever a "reasonable attorney could have foreseen that he would be subject to a malpractice claim."[44]

In the present case, an admission of negligence was made by an "insured" prior to the inception date of the policy. Sowerbutts's admitted negligence had caused a couple to lose their home. A "reasonable attorney" in the same position must necessarily foresee a malpractice claim. These facts clearly trigger the unequivocal language of Exclusion G, render the alleged injury outside the scope of the insurance contract and bar recovery under the policy. Plaintiffs cannot but concede that "Defendants had a basis on which to deny coverage."[45] This should end the dispute. The insurer's obligations were simply not triggered with respect to the instant claim.

Since Plaintiffs cannot show policy coverage to a claim clearly excludable by foreseeability, they cannot satisfy the prerequisite to recovery. There can be no breach of contract or fiduciary duty when the insurance contract itself is inapplicable and no duty is owed. Defendant Insurance Companies owed no more of a contractual or fiduciary duty to the Underlying Action than did any other existing Insurance Company.

2. Material misrepresentations rendered the contract void from its inception:

It is basic contract law that where there is no meeting of the minds, the parties cannot recover on a breach of contract theory.[46] For an enforceable contract to exist, the parties must mutually agree on the nature and extent of their mutual obligations and on the material and necessary details.[47] In the context of an insurance contract, the applicant owes a duty to make full

[44] *Id*.
[45] *Id*. at 16 ¶ 88
[46] Northeast Fence & Iron Works, Inc. v. Murphy Quigley, 933 A.2d 664, 666 ¶7 (Pa. Super. 2007)
[47] Lackner v. Glosser,. 892 A.2d 21, Pa.Super., 2006

disclosure of all things material to the risk.[48] The key issue here is whether Plaintiffs had knowledge of a potential claim when they answered "no" on the insurance application.

Pennsylvania courts recognize that the Rules of Professional Conduct impose duties on lawyers practicing within this state.[49] Partners, Managers and Supervisory Lawyers at Plaintiffs Law Firm have a mandatory obligation to ensure that "all lawyers in the firm conform to the Rules of Professional Conduct,"[50] including Competence[51] and Diligence.[52] This duty required Partners, Managers and Supervisory Lawyers at the Law Firm to have knowledge of Sowerbutts's admitted malpractice. It is fair to attribute constructive knowledge to the Law Firm, even if not every member had actual knowledge. With this attribution, it becomes clear that answering "no" to the application question asking about potential claims was a material misrepresentation. The insured had constructive knowledge of a material risk which the insurer did not agree and cannot be forced to insure.

In effect, the insurer was not made aware of the nature and extent of their obligation to insure the claim. This was a material and necessary obligation and risk that was not brought to the attention of, or agreed to by the insurer. Not only did this afford Plaintiffs a cheaper premium on the policy but it also deprived Defendant Insurance Companies from ability to properly assess insurability of the risks involved. There was no meeting of the minds on the overall contract and Plaintiffs cannot recover on a breach of contract theory.

Furthermore, the standard to determine whether an attorney knew or could have reasonably foreseen that an error could be a basis of a claim and whether the policy provided

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[48] Rohm and Haas Co. v. Continental Cas. Co., 732 A.2d 1236 (Pa. Super. Ct. 1999), appeal granted and judgment aff'd, 781 A.2d 1172 (Pa. 2001).
[49] Rizzo v. Haines, 555 A.2d 58, 67 (Pa.1989); Commonwealth Ins. Co., v. Graphix Hot Line Inc., 808 F.Supp. 1200 (E.D.Pa.1992); Caplan v. Braverman, 876 F.Supp. 710 (E.D.Pa.1995); Simms v. Exeter Architectural Products, Inc., 868 F.Supp. 677 (M.D.Pa.1994)
[50] See PA ST RPC Rule 5.1(a)
[51] *Id*. at 1.1
[52] *Id*. at 1.3

coverage is "objective".[53] In Mt. Airy Ins. Co. v. Thomas,[54] the Western District of Pennsylvania federal court held that the standard was objective rather than subjective.[55] After considerable research of case law from other jurisdictions, Thomas predicted that the "Pennsylvania Supreme Court, if faced with the present facts, would apply an objective "reasonable person" standard."[56] Thomas defined the "objective standard" as that which "would give a reasonable person a basis to believe that a breach of a professional duty has occurred… [taking] into account facts or information the attorney knew or possessed."[57]

Applying this standard to the present facts requires a finding that a "reasonable" attorney in Sowerbutts's position would have foreseen the Underlying Action. Sowerbutts was retained to prevent the sale of a home by filing a petition. He must have been aware that his failure to do so would cause the house to be sold and his clients to be unnecessarily evicted. It is an inescapable conclusion that a "reasonable attorney" in the same position would expect a malpractice claim. Since former employees fit the definition of "insured" under the policy, it is undeniable that answering "no" on the insurance application was a material misrepresentation. "Reasonable" Partners, Managers and Supervisory Lawyers at the Law Firm are expected to have knowledge of foreseeable malpractice claims against their employees and subordinates.

Since the language of Exclusion G unequivocally excludes coverage of the instant claim and the insurance application was tainted with a material misrepresentation, Motion for Judgment on the Pleadings is granted as to Plaintiffs allegations of breach of contract and breach of fiduciary duty.

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[53] See Ehrgood v. Coregis Ins. Co264 F. 3d 302 (3rd Cir. 2001)
[54] 954 F.Supp. 1073 (W.D. Pa. 1997)
[55] *Id*.
[56] *Id*. at 1080
[57] *Id*. at 1079

There was no Negligent Misrepresentation by the Insurer or Detrimental Reliance by the Insured because any Reliance by the Insured was not justifiable and was not the result of inducement by misrepresentation

Counts IV and V of the Complaint allege Negligent Misrepresentation and "Estoppel / Detrimental Reliance" respectively. The complaint pleads the same facts with respect to both Counts. It alleges that "Defendants represented to Plaintiffs that coverage for defense and indemnity was being provided for one year by their actions, omissions and representations."[58] The complaint goes on to allege that Defendants represented that they "were protecting Plaintiffs interests by their actions, omissions and representations,"[59] and that "Plaintiffs justifiably relied upon such representations to their detriment."[60] Finally, Plaintiffs allege that "as a direct and proximate result of Defendants' misrepresentations, [Plaintiffs] suffered damages of $200,000"[61] and were prejudiced in their defense. The issues here are whether Defendant Insurance Companies made any such representations as to induce Plaintiffs to justifiably rely on Defendants to handle their defense in the Underlying Action and whether Plaintiffs defense payments were incurred as the result of any reliance.

A "negligent" misrepresentation is a misrepresentation which arises from want of reasonable care in obtaining or communicating information.[62] Equitable estoppel is a doctrine sounding in equity which acts to preclude one from doing an act differently than in the manner in which another was induced by word or deed to expect. Negligent Misrepresentation and Estoppel are similar in that they both require: (1) inducement by misleading or misrepresentation; and (2) justifiable or reasonable reliance on the false information.[63]

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[58] Second Amended Complaint, p.22 ¶110
[59] *Id*. at ¶ 111
[60] *Id*. at ¶ 122
[61] *Id*. at ¶115
[62] Woodward v. Dietrich, 548 A.2d 301 (Pa.Super., 1988)
[63] Negligent Misrepresentation requires proof of: (1) misrepresentation of material fact; (2) made under circumstances in which misrepresenter ought to have known its falsity; (3) with intent to induce another to act on it;

The doctrine of equitable estoppel is applicable whenever a party, either by act or representation, intentionally or negligently induces another to believe certain facts, and the other justifiably relies and acts upon that belief, so that he will be prejudiced if the former is permitted to deny the existence of such facts.[64] When these elements are met and estoppel is established, the person inducing the belief in the existence of certain facts is estopped from denying these facts or from repudiating his acts, conduct, or statements.[65]

It is well established that the burden rests on the party asserting equitable estoppel to establish such estoppel by clear, precise and unequivocal evidence.[66] It is a doctrine of fundamental fairness, dependent on the particular facts of each case.[67] Without inequitable conduct, it is not so easily invoked. The representation or conduct must itself have been sufficient to warrant the action of the party claiming estoppel. If notwithstanding such representation or conduct he was still obliged to inquire into the existence of other facts to sustain the course of action adopted, he cannot claim that the conduct of the other party was the cause of his action and no estoppel will arise.[68] Also, where there is no concealment, misrepresentation, or other inequitable conduct by the other party, a party may not properly claim estoppel in his favor from his own omission or mistake.[69] Estoppel cannot be predicated on error of judgment by the person asking its benefit.[70]

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and (4) which results in injury to party acting in justifiable reliance on misrepresentation. Bortz v. Noon, 729 A.2d 555, 561. Estoppel requires: (1) misleading words, conduct, or silence by the party against whom estoppel is asserted; (2) unambiguous proof of reasonable reliance upon the misrepresentation by the party asserting the estoppel; and (3) the lack of a duty to inquire on the party asserting the estoppel." Chester Extended Care Center v. Department of Public Welfare, 526 Pa. 350, 355, 586 A.2d 379, 382 (1991).

[64] In re Estate of Tallarico, 425 Pa. 280, 288, 228 A.2d 736, 741 (1967)

[65] *Id.* at 425 Pa. at 288, 228 A.2d at 741

[66] Blofsen v. Cutaiar, 460 Pa. 411, 333 A.2d 841 (1975)

[67] Com., Dept. of Revenue, Bureau of Sales and Use Tax v. King Crown Corp., 415 A.2d 927 Pa.Cmwlth., 1980.

[68] Northwestern Nat. Bank v. Commonwealth, Pa. 27 A.2d 20, 23 (1942)

[69] *Id.*

[70] *Id.*

In the instant case, the facts as pled do not meet the requirements of equitable estoppel. Of the eleven exhibits attached to the complaint, none demonstrate that Defendant Insurance Companies ever unequivocally agreed to defend or indemnify the Underlying Action. Although they were not obligated, Defendants retained temporary counsel for Plaintiffs and appropriately protected their interests until Plaintiffs could protect their own interests. Defendants very first communication with Plaintiffs after being notified of the claim was a letter in which Defendants "reserve[d] all rights under the policy" while reviewing all relevant information.[71] Plaintiffs' citation of this letter as an acceptance of the claim is insupportable.[72] Although the court must accept as true all well pled statements of fact, it does not have to accept mischaracterizations of law. The pleadings are absent of any document on which Plaintiffs can base any inducement or justifiable reliance.

Even assuming arguendo that the claim had been accepted, Defendants clearly reserved all rights under the policy in the first letter. Their three subsequent letters dispel any possible inducement or justifiable reliance. In the first, Plaintiff was put on clear notice that the claim may not be within coverage.[73] In the second, Plaintiff was put on clear notice that coverage was denied.[74] Finally, in the third letter, disclaimer of coverage was confirmed.[75] Although Defendants allowed counsel to continue to represent Plaintiffs, these four letters make it obvious that the reliance Plaintiffs had on a continued free defense was misplaced and unjustified.

The complaint alleges that Defendants continued representation of Plaintiffs estops Defendants from terminating representation. This allegation is insupportable. Plaintiffs concede

[71] Second Amended Complaint, Exhibit C
[72] *Id*. at p.6 ¶ 29
[73] Second Amended Complaint, Exhibit D
[74] *Id*. at Exhibit F
[75] *Id*. at Exhibit H

that coverage was properly denied. Thus, Plaintiffs were indeed fortunate to be represented by retained counsel, free of charge, at all in the Underlying Action.[76] Also, this court finds no inequitable conduct or inducement to cause the insured to relinquish any management or defense of the case to the insurer. Plaintiffs could have at least monitored the protection of their interests. Plaintiffs cannot claim inducement or justifiable reliance in the face of two disclaimers attached to their own pleadings. An insurer may defend without admitting coverage. This is especially true when the insured is put on clear notice that the insurer reserves its right under the policy to deny coverage.

Laroch v. Farm Bureau Mutual Automobile Insurance Company,[77] involved an automobile insurance policy in which an uninsured driver took his insured brothers car and collided with another person causing her injury. The injured victim brought suit against both brothers. The insurance company agreed to defend the suit pursuant to an agreement that their defense was not a waiver of its right to disclaim liability under the policy. After verdict was rendered against the uninsured brother, plaintiff was unable to collect and brought suit against the insurance company. The Pennsylvania Supreme Court held that when such an agreement is entered into, the insurer does not, by defending the original suit, waive any rights or become estopped to repudiate liability in a subsequent action.[78]

Like the agreement in Laroch, the reservation of rights and disclaimer letters in the instant case prevent a finding of waiver or estoppel. These communications put the insured on notice that the insurer may revoke the defense and that any reliance on the insurer to defend would be misplaced. The policy of insurance only requires clear notice, as was given in the four letters from Defendants to Plaintiffs.

[76] The court notes that Defendants are not seeking reimbursement of their costs for Plaintiffs defense.
[77] 335 Pa. 478 (1939)
[78] *Id*. at 485

An insurer's duty to defend continues only until the claim is excluded from the scope of the policy.[79] When a claim is not within policy coverage and effective notice is given to the insured, the insurer is not estopped from terminating all payments. A reservation of rights in this respect, to be effective, need only be timely communicated to the insured.[80] Defendant Insurance Companies complied with this requirement. They are not estopped from denying coverage by continued participation in a defense that they did not owe on a claim that was outside policy coverage.

Finally, payments incurred by Plaintiffs were not the result of any inducement or conduct by Defendants. Plaintiff Law Firm committed negligent misrepresentation and would have been liable regardless of any conduct by Defendants. It is clear that Defendants conduct and Plaintiffs misplaced reliance did not increase or decrease the amount of damages that Plaintiffs incurred.

Since the pleadings fail as a matter of law to demonstrate inducement or justifiable reliance, two essential elements of estoppel and negligent misrepresentation, and Plaintiffs damages were not the result of Defendants conduct, Motion for Judgment on the Pleadings is granted with respect to Plaintiffs allegations of estoppel and detrimental reliance.

Insurer did not act in "Bad faith" because Insurer had a "reasonable basis" to deny coverage and did not act dishonestly or in self-interest

Count II of the Complaint alleges "Bad faith" in violation of 42 Pa.C.S.A. § 8371.[81] Plaintiffs allege that Defendants acted in bad faith in their "delay in completing investigation of

[79] Brugnoli v. United Nat'l Ins. Co. 284 Pa. Super. 511 (Pa. Super. 1981)
[80] *Id*. at 518 (citing Couch, Cyclopedia of Insurance Law s 51:83 (2d ed. 1965))
[81] Section 8371 provides that: 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:(1) 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 3%. (2) Award punitive damages against the insurer. (3) Assess court costs and attorney fees against the insurer.

the claim,"[82] in "failing to timely and effectively communicate results of their investigation,"[83] in "failing to instruct [Defendant] Law Firm to withdraw"[84] and in "denying coverage one year after suit was instituted… when discovery was expiring and trial was looming."[85] The issue here is whether Defendants acted unreasonably, dishonestly or in self-interest in any of the conduct described in these allegations.

Section 8371 does not define the term "bad faith." Nevertheless, the Superior court in Terletsky v. Prudential Property and Casualty Ins. Co.[86] defined "bad faith" as follows:

> "Bad faith" on part of insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will. Mere negligence or bad judgment is not bad faith.[87]

To recover on a bad faith claim, the insured must prove that the insurer: (1) did not have a reasonable basis for denying benefits under the policy; and (2) knew of or recklessly disregarded its lack of a reasonable basis in denying the claim.[88]

In the present case, the insurer had a reasonable basis to deny benefits under the policy. Plaintiffs do not dispute that. It is also clear that the insurer kept Plaintiffs fully advised at all times. Plaintiffs' were sent a letter on Feb. 20th, 2004 in which Defendants reserved their rights and advised that indemnity and coverage may be denied. Six months later, on Aug. 20th 2004, Plaintiffs were sent the first of two disclaimer letters, in which disclaimer was explained. Plaintiffs' complain that Defendants did not correspond "at any time from Feb. 20th, 2004 until

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[82] Second Amended Complaint, p. 18 ¶100(b)
[83] *Id*. at p. 19 ¶100(d)
[84] *Id*. at ¶100(h)
[85] *Id*. at ¶100(k)
[86] 437 Pa.Super. 108, 649 A.2d 680 (1994)
[87] *Id* at 688
[88] *Id*. See also Greene v. United Services Auto. Ass'n, 936 A.2d 1178 (Pa.Super.2007); Bombar v. West American Ins. Co., 932 A.2d 78 (Pa.Super.2007)

Aug. 20th, 2004 regarding their investigation of the claim and/or coverage."[89] Plaintiffs claim this six month period was bad faith. In Pittas v. Hartford Life Ins. Co.,[90] the Pennsylvania Western District Federal Court held that taking more than seven months to deny coverage, without more, is not bad faith.[91] Applied to the complaint, six months to investigate and decide to disclaim, while helping the insured Law Firm is not bad faith. Defendant Insurance Companies denied the claim because it was excluded from policy coverage and they had no duty to defend or indemnify. [92] Although coverage was clearly excludable, Defendants continued to pay for retained counsel. They do not now request to be reimbursed for the defense expenses they unnecessarily incurred. There was no bad faith by the insurer here.

Conclusion

Defendants are entitled to Judgment on the Pleadings as a matter of law. Defendants Motion for Judgment on the Pleadings is granted.

BY THE COURT

7/18/08 MARK I. BERNSTEIN, J.

[89] Second Amended Complaint, p.7 ¶33
[90] 513 F. Supp. 2d 493 (W.D. Pa. 2007) (applying Pennsylvania law)
[91] *Id*.
[92] Several cases have held that when an insurer has no duty to defend or indemnify its insured, it could not have acted in bad faith. See T.A. v. Allen, 868 A.2d 594, 599 (Pa.Super.2005) (insurer not liable for bad faith in absence of coverage); Pizzini v. American Intern. Specialty Lines Ins. Co., 249 F.Supp.2d 569, 570 (E.D.Pa.2003) (Professional liability insurer did not act in bad faith in violation of Pennsylvania bad faith statute when it refused to indemnify insured for settlement amount in underlying action, as insurer did not have duty, under policy, to indemnify insured); Frog, Switch & Manufacturing Co., Inc. v. Travelers Ins. Co., 193 F.3d 742, 751 n. 9 (3d Cir.1999) (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).