Bad Faith, Fraud, Choice of Law, Direct Physical Loss Coverage Update

March 15, 2021

Bad Faith – California

Pinto v. Farmers Ins. Exch.
No. B295742, 2021 WL 857776 (Cal. Ct. App. Mar. 8, 2021)

The California Court of Appeals overturned a $9.9 million bad faith verdict against Farmers Insurance Exchange (Farmers) arising out of Farmers' alleged failure to settle a car crash claim. The appellate court ruled bad faith claims must demonstrate a finding that an insurer acted unreasonably.

The case arose out of a 2013 automobile accident in which the plaintiff suffered injuries causing quadriplegia, and the owner of the vehicle suffered brain damage. The driver and three passengers were coming from a party where drugs and alcohol were present. Alaxandrea Martin (Martin), a passenger at the time of the accident, owned the truck, which was insured under an auto policy issued by Farmers. There was some confusion about who was driving the vehicle, but it was ultimately determined that Dana Orcutt (Orcutt) may have been driving the vehicle at the time with Martin's permission.

Orcutt assigned her rights under the Farmers policy to the plaintiff who then presented Farmers with a settlement offer. However, the proposed settlement required Farmers to furnish a declaration on Orcutt's insurance coverage and Orcutt refused to cooperate in providing insurance information and signing a declaration. Faced with a time limited settlement demand, which included as a condition a signed declaration from Orcutt with her insurance information, Farmers ultimately sent the plaintiff a $50,000 check for the claim without the requested declaration from Orcutt.

It his suit, the plaintiff claimed that Farmers acted in bad faith in handling the plaintiff's claim and failing to settle. A jury returned a verdict in the plaintiff's favor, and the court entered a $9.9 million judgment against Farmers.

The appellate court unanimously overturned the verdict, reasoning that "[t]he special verdict here was facially insufficient to support a bad faith judgment because it included no finding that Farmers acted unreasonably in failing to accept Pinto's [the plaintiff's] settlement offer." Without such a determination of unreasonableness, the jury's verdict was "deficient," and the judgement was "defective." Even though the plaintiff submitted evidence of unreasonableness by Farmers, because the jury was not

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instructed to determine the issue, the evidence was "irrelevant." The plaintiff further argued that he had suggested a question on the verdict form that spoke to Farmers' reasonableness, to which Farmers objected. The appellate court rejected this estoppel argument, asserting that the plaintiff was responsible for the shortcomings of the verdict form. The appellate court reversed the judgment in favor of the plaintiff and remanded the case to the trial court with an instruction to enter a judgment in favor of Farmers.

Fraud and Choice of Law – Delaware

RSUI Indem. Co. v. Murdock
--- A.3d ---, 2021 WL 803867 (Del. Mar. 3, 2021)

The Supreme Court of Delaware held that coverage under a Directors' and Officers' policy (D&O policy) for claims of intentional wrongdoing and fraud by an insured CEO did not violate Delaware public policy. The excess insurer, RSUI Indemnity Company (RSUI), appealed a series of decisions from the Superior Court of Delaware ruling in favor of the insureds, Dole Food Company, Inc. (Dole) and Dole's director and CEO, David H. Murdock (Murdock). RSUI sought a declaration from the Superior Court that coverage under its D&O policy was unavailable to fund Dole and Murdock's settlement of underlying state and federal lawsuits that current and former Dole shareholders filed based on Murdock's fraudulent conduct related to a merger transaction that took Dole private and resulted in Murdock acquiring all of Dole's stock.

RSUI argued that Delaware law – and not California law – governed the interpretation of the D&O policy, that fraudulent conduct by Murdock was uninsurable under either state's laws, and that the "Fraud/Profit Exclusion" defeated coverage for the settlements in the state and federal actions. The appellate court first held that Delaware had a more significant interest in its law being applied because that is where Dole is incorporated, even though California is the location of Dole's headquarters and the residence of Dole's directors and officers. Delaware had a stronger "interest in protecting the ability of its considerable corporate citizenry to secure D&O insurance and thereby attract talented directors and officers[.]"

Turning to the substantive issues, the appellate court held that allegations of fraud "fit comfortably within the [] terms defining the scope of coverage," and that Delaware does not have a public policy "against the insurability of losses occasioned by fraud so strong as to vitiate the parties' freedom of contract[.]" In other words, Delaware public policy "weighs in favor of the insurability of losses incurred as the result of a breach of the duty of loyalty, including one marred by fraud." Lastly, the appellate court held that the Fraud/Profit Exclusion did not bar coverage because the provision only excluded "fraudulent act[s] ... established by a final and non-appealable adjudication adverse to [the] Insured in the underlying action," and RSUI was obligated to pay the settlement in the federal action, which occurred without a final and non-appealable adjudication.

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Direct Physical Loss of or Damage to Property – California and New York

Kingray Inc. v. Farmers Group Inc.
No. EDCV 20-963 JGB (SPx), 2021 WL 837622 (C.D. Cal. Mar. 4, 2021)

Plaintiffs Kingray Inc. (Kingray), a sports bar and grill in California, and Nora's Style Salon, Inc. (Nora's), a beauty salon in New York, filed a class action complaint against their insurers Farmers Group, Inc., Farmers Insurance Company, Inc., and Truck Insurance Exchange. Kingray and Nora's alleged that COVID-19 related business losses, incurred by them and others similarly situated, were covered under their all-risk commercial property policies. In response, the insurers filed a motion to dismiss.

In deciding the insurers' motion to dismiss, the district court recognized that New York law applied to the interpretation of the all-risk policy issued to Kingray, whereas California law applied to the policy issued to Nora's. The court then ruled that the virus exclusion in Kingray's policy "plainly defeated" its "theory that the coronavirus itself triggers Kingray's insurance coverage." Accordingly, the court dismissed Kingray's claims against its insurer.

The all-risk policy issued to Nora's did not, however, contain a virus exclusion, which necessitated the court's interpretation of the "central clause 'direct physical loss of damage to property.'" Initially, the court recognized that the words "direct" and "physical" modified both "loss" and "damage." "The most natural reading of the phrase is that Nora's is insured for direct physical loss of its property and also insured for direct physical damage to its property."

Given that neither COVID-19 nor New York's "stay at home" orders caused partial or complete physical destruction of the insured property, there was not a "direct physical loss." However, the court recognized that actual physical loss may not be required for a "direct physical loss." Instead, physical dispossession of the property may be sufficient. The court explained that it was "plausible that 'direct physical loss of' property includes physical dispossession because of dangerous conditions (a virus in the air) or a civil authority requiring Nora's to close." Accordingly, the court denied the insurers' motion to dismiss Nora's claims for coverage.

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