Alert
December 16, 2013

Global Insurance Alert
News Concerning Bad Faith and Extracontractual Issues

COZEN O'CONNOR

Pennsylvania District Court Considers Bad Faith Set-up as Affirmative Defense

As a matter of first impression under Pennsylvania law, the court in *Shannon v. New York Central Mutual Insurance Company*, No. 13-cv-1432 (M.D. Pa. Nov. 20, 2013) denied a motion to strike an insurer's defense of "bad faith set-up," asserted in response to a bad faith claim based on the insurer's alleged failure to settle a claim.

Shannon involved an underlying auto collision case in which the plaintiffs made a pre-suit policy limits demand of $25,000 to the driver's insurer. The driver's insurer rejected the $25,000 demand and instead offered to settle the collision claim for $12,500. According to briefs filed by the driver's insurer, although plaintiffs provided some information in support of the demand, there was insufficient information to make a determination of liability. Plaintiffs rejected this counteroffer and filed suit on March 8, 2004. Depositions in the underlying litigation occurred in mid-August 2004. On September 1, 2004, some two weeks after depositions, the driver's insurer offered the $25,000 policy limits settlement to resolve the case. The plaintiffs rejected the offer on the basis that it came only after plaintiffs had incurred time and expense related to discovery. The underlying matter proceeded to trial and the jury awarded the plaintiffs $1,106,000.

The plaintiffs received an assignment of the insured driver's rights and initiated litigation in federal district court against the driver's insurer, asserting that the driver's insurer violated the duty of good faith and fair dealing by failing to settle upon receipt of the initial demand when it was clear that the insured driver would be exposed to an excess verdict. In response to plaintiff's causes of action, the driver's insurer asserted as an affirmative defense that the plaintiffs orchestrated a "bad faith set-up" to recover punitive damages under Pennsylvania's bad faith statute, 42 Pa. C.S.A. § 8371. According to the driver's insurer, a "bad faith set-up" consists of "a quick settlement demand, followed by a quick closing of the window before important information is provided so that any subsequent limits offers by the insurer are bemoaned as too late." The driver's insurer further alleged that the plaintiffs' conduct included "creating pretexts and manufacturing conditions under which the main goal was ***not*** to settle the underlying matter at fair and reasonable value, but rather to manufacture the very bad faith claim the Plaintiffs' [sic] now makes" (emphasis in original).

The plaintiffs moved to strike the driver's insurer's bad faith set-up defense, arguing that Pennsylvania law did not recognize such a defense. The district court denied plaintiffs' motion, holding that although the driver's insurer did not cite any Pennsylvania law recognizing this affirmative defense, the allegations "would, if proven, assist in establishing an 'avoidance' under the terms of Federal Rule of Civil Procedure 8(c)." The district court further commented that the bad faith assessment would require review of the communications between the driver's insurer and plaintiffs' counsel.

Recently, on December 5, 2013, the plaintiffs/assignees filed a motion for reconsideration and again requested that the court strike the bad faith set-up defense in its entirety. Plaintiffs asserted that the district court committed a clear error of law and argued that "the conduct of the claimant or her counsel in the underlying third party action cannot, as a matter of law, form the basis of a defense or avoidance of Plaintiff's claims."

While the district court has not yet ruled on the motion for reconsideration, its original holding demonstrates a court's willingness to consider the realities of current-day litigation. *Shannon* recognizes that plaintiffs often use bad faith claims as part of a litigation strategy designed to create leverage through the threat of subsequent bad faith litigation in the event that a settlement is not achieved. Litigants can then use such a threat to place carriers in an untenable position – either pay before liability can be reasonably determined or risk losing the ability to settle – with all the consequences that entails. Even when the decision to refuse a quick, early settlement is

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reasonable, a carrier might have to litigate both the underlying lawsuit and a subsequent “bad faith” lawsuit, with all the associated costs. The *Shannon* decision may ultimately present a valuable tool for insurers facing bad faith set-ups and the use of the affirmative defense of avoidance is something to remember to include in an insurer’s quiver.

To discuss any questions you may have regarding the issues discussed in this Alert, or how they may apply to your particular circumstances, please contact Deborah Minkoff in Philadelphia at (215) 665-2170 or dminkoff@cozen.com or Abby Sher in Philadelphia at (215) 665-2761 or asher@cozen.com.