INSURANCE COVERAGE LAW BULLETIN

JANUARY 2015

The Impact of Bad-Faith Arguments on Forum Battles

By **Caroline Marks** and **Alexandra V. Dattilo**

Policyholders and insurers alike regularly find themselves in protracted forum battles because, rightly or wrongly, the parties view choice of forum as having a major impact on the choice of state law to be applied to important coverage issues. Coverage law, of course, varies significantly among jurisdictions, and choice of law actually can be outcome determinative in certain cases. In contesting such forum battles, policyholders have a tool that may be underutilized — the argument that insurers engage in bad faith when they file pre-emptive declaratory judgment actions to attempt to seize control of forum selection.

At first, this may seem counterintuitive, because insurers often file declaratory judgment actions to avoid exposure to bad faith, particularly after they have agreed to defend their policyholders under reservations of rights. There are, however, circumstances in which an insurer's filing of a declaratory judgment action can give rise to a bad-faith claim that a policyholder may use to its advantage in a forum battle. This article analyzes instances when an insurer's institution of a declaratory judgment action demonstrates bad faith such that it weighs against the insurer's choice of forum.

The Duty of Good Faith and Fair Dealing

It is long settled that an insurer owes a duty of good faith and fair dealing to its policyholder. *See Allstate Ins. Co. v. Miller*, 212 P.3d 318, 324 (Nev.2009); *Kransco v. Am. Empire Surplus Lines Ins. Co.*, 2 P.3d 1, 8 (Cal.2000); *Zoppo v. Homestead Ins. Co.*, 644 N.E.2d 397, 399 (Ohio 1994). Attendant to this duty is the insurer's obligation not to place its own interests above those of its policyholder. *Nat'l Sur. Corp. v. Immunex Corp.*, 297 P.3d 688, 691 (Wash.2013) ("Because security and peace of mind are principal benefits of insurance, insurers must fulfill their contractual obligations in good faith, 'giving equal consideration *in all matters* to the insured's interests.'") (quoting *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133 (Wash.1986)) (emphasis in the original). Thus, "at a minimum, an insurer must equally consider the insured's interests and its own." *Miller*, 212 P.3d at 326. "An insurer cannot escape liability for breach of the duty of good faith by acting upon what it considers to be its interest alone." *Boston Old Colony Ins. Co. v. Gutierrez,* 386 So.2d 783, 786 (Fla.1980).

To satisfy its good-faith obligations, it is not uncommon for an insurer to defend its policyholder under a reservation of rights and contemporaneously file a declaratory judgment action to determine coverage questions. Depending on the facts, courts have held that such a course of action may shield the insurer from claims of bad faith. *See, e.g., Guaranty Nat'l Ins. Co. v. George*, 953 S.W.2d 946, 949 (Ky.1997) (holding that the insurer's conduct did not "rise to the level required to sustain an action for bad faith" where the insurer provided a defense to the policyholders and the underlying claim proceeded without delay); *Cay Divers, Inc. v. Raven*, 812 F.2d 866, 871 (3d Cir.1987) ("In general, an insurer's seeking of a declaratory judgment on potential coverage and on the duty to defend dependent thereon before the trial on the main action does not support a charge of bad faith.") (citing 7C Appleman, Insurance Law and Practice § 4686, at 177-78 (Berdal ed. 1979)); *Victoria Ins. Co. v. Li He Ren*, No. 08-517, 2008 U.S. Dist. LEXIS 44674, at *10 (E.D. Pa. June 9, 2008) (rejecting a bad faith claim, stating that "[the insurer] has proceeded as we expect a responsible insurer to proceed when it has a legitimate coverage question; it has assumed the defense of [the insureds] in the State Court action and filed a declaratory judgment action in this Court").

The mere filing of a declaratory judgment action, however, does not automatically protect an insurer against claims of bad faith. As observed by the Kentucky Supreme Court, "[c]learly, one can envision factual situations where an insurer could abuse its legal prerogative in requesting a court to determine coverage issues." *George*, 953 S.W.2d at 949; *see Mut. of Enumclaw Ins. Co. v. Dan Paulson Constr., Inc.*, 169 P.3d 1, (Wash. 2007) (holding that insurer acted in bad faith by pursuing a declaratory judgment action where its actions prejudiced its policyholder's tort defense); *see generally Great Southwest Express Co. v. Great Am. Ins. Co.* , 665 S.E.2d 878 (Ga.App.2008) ("[T]he mere filing of a declaratory judgment action does not in and of itself absolve an insurer from being subject to a bad faith penalty under OCGA § 33-4-6."); *Nat'l Union Fire Ins. Co. of Pittsburgh, PA. v. Small Smiles Holding Co., LLC*, 781 F.Supp.2d 597, 601-602 (M.D.Tenn.2011) (declining to dismiss insured's claim for unfair or deceptive practices under the Tennessee Consumer Protection Act based on allegations that the professional liability insurer had instituted a baseless declaratory judgment action to avoid its contractual obligations).

Accordingly, while an insurer may be able to insulate itself from bad faith by pursuing a declaratory judgment action to resolve coverage issues in certain instances, it may expose itself to bad-faith allegations in others. One instance when an insurer may expose itself to allegations of bad faith is when it files a declaratory judgment action as a preemptive strike to deny a policyholder its choice of forum.

Impact of Bad Faith in Forum Battles

Regarding the proper forum, courts are "mindful of the general proposition that declaratory judgments are not to be used defensively to deny a prospective plaintiff's choice of forums." *Prudential Ins. Co. of Am. v. Doe*, 140 F.3d 785, 790 (8th Cir.1998). In furtherance of this belief, courts do not encourage "procedural gamesmanship" or "reward a party for winning a race to the courthouse" when it has done so by a party acting in bad faith. *White Light Prods v. On the Scene Prods.*, 231 A.D.2d 90, 98 (N.Y.1997). This is precisely the reason that courts are not inclined to follow the first-to-file rule when there is evidence of a party acting in bad faith because doing so would be unjust. *See Royal Ins. Co. v. Packing Coordinator, Inc.*, No. 00-CV-3231, 2000 U.S. Dist. LEXIS 14174, *8 (E.D.Pa. Sept. 20, 2000); *see also AmSouth Bank v. Dale*, 386 F.3d 763 (6th Cir.2004) (stating that the fact that the plaintiff participated in settlement negotiations and represented it was continuing to participate in the negotiations but instead filing a lawsuit weighs heavily against entertaining the declaratory judgment action filed by plaintiff).

"Bad faith is evident when the plaintiff in the first action induces the other party to, in good faith, rely on representations made by the plaintiff that it will not file first in order to preempt the other party from filing a suit in its preferred forum." *Nat'l Union Fire Ins. Co. v. Payless Shoesource, Inc.*, No. C-11-1892 EMC, 2012 U.S. Dist. LEXIS 112346, *21 (N.D.Cal. Aug. 9, 2012); s*ee also Zide Sport Shop of Ohio, Inc. v. Ed Tobergte Associates*, 16 Fed. Appx. 433 (6th Cir.2001) (stating that because plaintiffs mislead the defendant by asking for an extension of time for negotiating a settlement and then filed a lawsuit before that time expired "[a] finding of bad faith is overwhelmingly supported by the record"); *White Light Prods.*, 231 A.D.2d at 100 (stating that

"[d]efendants should not be rewarded for their precipitous filing, approximately a week after learning of plaintiffs' intention to bring an action, placing venue in a distant forum"). As evidenced by this history and by more recent cases, courts unquestionably take bad-faith conduct into account in deciding forum disputes between insurers and policyholders.

Sensient Colors, Inc. v. Allstate Ins. Co.

In *Sensient Colors*, for example, the New Jersey Supreme Court addressed whether the "special equities" in that case, including the insurer's preemptive filing of a declaratory judgment action against the policyholder, warranted denying the insurer's request for a comity dismissal of the second-filed New Jersey action. *Sensient Colors, Inc. v Allstate Ins. Co.*, 939 A.2d 767 (N.J.2006). In the underlying claims, a landholder had sued Sensient, the policyholder, for damages resulting from the environmental contamination of the landlord's property located in New Jersey. *Id*. at 771. The New Jersey Department of Environmental Protection was later joined as a defendant and cross-claimed against Sensient, seeking to recover costs it incurred in cleaning up the subject environmental site. *Id*. In addition to this lawsuit, the EPA demanded that Sensient reimburse the EPA for remediation previously performed at the site and that it pay for any additional work that may have been necessary for further remediation of the site. *Id*.

Sensient notified its insurers, which had issued commercial liability insurance policies to Sensient's predecessor, of both the lawsuit and the EPA's reimbursement demand. *Id* . One of those insurers, Zurich, agreed to provide a defense for those claims under a reservation of rights. *Id*. Several months later, and without providing any notice or warning to Sensient, Zurich reversed its position, disclaimed coverage, and filed a declaratory judgment action in New York. *Id*. Approximately two months later, Sensient filed its own declaratory judgment action in New Jersey, "[seeking] compensatory damages from those insurers who expressly denied coverage and punitive damages from Zurich for breaching the duty of good faith and fair dealing owed to its insured." *Id*. at 772.

The trial court granted Zurich and other defendant-insurers' motions to dismiss the New Jersey action on comity grounds. *Id* . The Appellate Division, however, reversed that trial court determination. In affirming the Appellate Division's reversal, the New Jersey Supreme Court held that the special equities favored the trial court exercising jurisdiction over the second-filed New Jersey action, rather than dismissing it. *Id*. at 780. Included among the special equities cited by the court was Zurich's bad-faith institution of the declaratory judgment action to deprive Sensient of its choice of forum. The court reasoned:

> After Sensient notified Zurich of the [civil] suit and the EPA reimbursement demand, the insurer informed Sensient that it would participate in the defense of those matters under a reservation of rights. Without a denial of coverage by Zurich, Sensient had little reason to file an action in New Jersey for a declaration of its rights. In a preemptive move similar to the one condemned in [*Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983)], Zurich without warning filed suit in New York, thereby denying Sensient the opportunity to select its own forum for resolving the coverage dispute. An insurer has a duty to act in good faith with its insured. *See Pickett v. Lloyd's*, 131 N.J. 457, 467, 621 A.2d 445 (1993). Here, Zurich engaged in a first-strike maneuver, filing suit in New York while a lulled Sensient sat on its rights.

Id. at 778-779. The court later posited that "Zurich's jockeying for the more hospitable insurance laws of New York best explain[ed] its selection of New York as its favored forum." *Id* . at 780. Accordingly, in *Sensient Colors*, the insurer's decision to engage in a "first-strike maneuver" to the detriment of its policyholder weighed against its choice of forum.

National Union Fire Ins. Co. of Pittsburgh, PA v. PolyOne Corp.

Another example of a court considering whether an insurer has acted in bad faith as a result of filing a declaratory judgment action against a policyholder can be found in *National Union Fire Ins. Co. of Pittsburgh, PA. v. PolyOne Corp.*, No. 653776/2013 (N.Y. Sup. Ct., New York County). In that case, the policyholder and one of its insurers were engaging in settlement negotiations concerning coverage for an environmental site in New Jersey when, without warning, the insurer filed a declaratory judgment action in New York to have its coverage obligations determined. Approximately two months later, the policyholder commenced a corresponding coverage action in New Jersey. The policyholder contemporaneously filed a motion to dismiss the New York action, arguing, among other things, that the first-to-file rule should not be followed where the insurer acted in bad faith by initiating a declaratory judgment action in New York for the singular purpose of preventing the policyholder from bringing a lawsuit in the forum it believed to be the rational and appropriate one for deciding the dispute.

In ruling on the motion, the New York court explained that, under New York law, where the commencement of two actions is reasonably close in time, the first-to-file rule should not be applied literally where procedural gamesmanship and the race to the courthouse are involved. While the court did not specifically address whether the insurer's conduct amounted to bad faith, it expressly took account of the insurer's aggressive and precipitant conduct, as other New York courts have done. *See Continental Ins. Co. v. Amax, Inc.*, 192 A.D.2d 391 (N.Y.App.1993) (upholding dismissal of the insurer's action in New York in favor of the insured's action in Colorado, stating that "[s]ince plaintiff commenced this action at a time when negotiations for settlement of these claims were taking place, we afford plaintiff no benefit from having commenced this action before [the insured] commenced its similar Colorado action").

Conclusion

Bad-faith considerations, such as an insurer's decision to preemptively file a declaratory judgment action in order to deprive a policyholder of its choice of forum, can resonate with a court deciding a forum battle — and weigh against the insurer's choice of forum. Although each case will turn on its own facts, it is important for policyholder counsel to be cognizant of the impact that such bad-faith considerations can have on forum battles in order to provide the most effective representation in coverage litigation.

Caroline Marks, an OSBA Certified Specialist in Insurance Coverage Law, is a shareholder and **Alexandra V. Dattilo** is an associate in the Cleveland, OH, office of Brouse McDowell. They regularly represent policyholders in connection with insurance coverage disputes. Brouse McDowell is one of the law firms representing PolyOne in regard to the case referenced in this article.