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LEGAL Dimensions

By: Nicollette Dailey, Partner Morrison Mahoney LLP

Mass. Appeals Court Awards Bad Faith Damages Despite $0 Judgment Against Insured

By Massachusetts statute, an insurer must conduct a reasonable investigation of a claim, considering all information available to it, before denying a claim. Insurers must also effectuate prompt, fair and equitable settlement of claims where liability has become reasonably clear. The Massachusetts Appeals Court recently considered the requirement of a reasonable investigation and analyzed the impact of potential joint tortfeasors on the duty to make an offer to settle.

In **Daniel McLaughlin v. American States Insurance Company**, No. 15-P-729 (August 12, 2016), the Massachusetts Appeals Court held that an insured's liability may be reasonably clear even if additional tortfeasors are potentially liable. Moreover, the fact that a judgment against the insured results in no monetary damages does not affect the availability of bad faith damages in the form of loss of use of settlement funds where the insurer had failed to promptly make a reasonable offer to settle when liability became reasonably clear. The court highlighted the importance of an independent assessment of an insured's liability in making a reasonable investigation of a claim as required by statute.

Background

In 2003, Assurance Construction Inc. served as general contractor on the construction of a house for Daniel and Rachel McLaughlin on a peninsula on Cape Cod. The project included a substantial landscaping component. In connection with the landscaping, Assurance subcontracted Waterworks Irrigation Inc. to install a multizone irrigation system to be served by a well. Waterworks, in turn, subcontracted Shaun Harrington to install the well.

In April 2003, Harrington drilled the well at a location on the property approximately 110 feet from the shoreline. Harrington then tested the well water by tasting it. Harrington was satisfied that the water tasted fresh and that the well produced water at a rate which was adequate to meet the needs of the irrigation system. While Harrington was on site, Andrew Miller, Harrington's friend and a hydrogeologist from Florida who was visiting family nearby, coincidentally stopped by to see Harrington. Miller tested the water with portable meters and testing strips and concluded the water was fresh, though he did not record his results.

Harrington knew that wells drilled close to sea water might turn from fresh to saltwater by means of a process called "upconing." Prudent practice of well drillers in the area at the time was to test the well water at regular intervals after drilling the well. Nonetheless, Harrington did not test the well water after his initial taste test, and he did not advise Waterworks or the McLaughlins of the possibility of upconing or that they should regularly test the water.

In May and June 2003, landscape plantings were installed at the property. In July and August 2003, the plantings showed signs of damage. In late August 2003, the McLaughlins discovered that the damage to the plants was caused by saltwater produced by the well and used for irrigation.

The Claim

The Appeals Court provided a detailed history of the handling of the McLaughlins' claim. On October 22, 2003, Assurance, at the McLaughlins' request, submitted a claim to Harrington's insurance agent which reached Harrington's carrier, American States Insurance Company (ASIC), on November 3, 2003. The claim included an invoice for plants purportedly killed by saltwater, totaling approximately $28,000. The claim form submitted by Harrington's agent indicated its belief that Harrington was not at fault.

ASIC assigned a claims adjuster. On November 4, 2003, the adjuster wrote to Ms. McLaughlin at her primary residence in Connecticut, asking her to contact the adjuster as soon as possible. Having received no response, the claims adjuster sent a second request one week later. The adjuster also contacted the nursery requesting a legible copy of the invoice, which ASIC received on November 10, 2003. The claims adjuster had authority to settle claims up to $10,000 and was required to inform her supervisor of claims for larger amounts. Nonetheless, she did not inform her supervisor of the McLaughlins' claim, which was more than $28,000 at that time.

On November 5, 2003, the adjuster called Harrington and obtained his recorded statement. Harrington described the upconing of the well as an "act of god." He also advised the adjuster that a certified hydrogeologist had done a conductivity test and that Harrington believed a report was prepared. The adjuster wrote a letter to Harrington that day requesting a copy of all paperwork

related to the loss, specifically including the hydrogeologist's report.

The adjuster took no further action on the claim for more than two months until January 26, 2004, when the McLaughlins' insurance agent contacted her about the claim status. The agent provided the claims adjuster with the McLaughlins' telephone number. The adjuster then spoke with Ms. McLaughlin, who expressed concern with the length of time of the claim processing and also attempted to correct purportedly inaccurate facts provided by Harrington. That day, the adjuster sent a confirmation letter to the McLaughlins and sent Harrington a second request for documents.

The claim again sat idle until the McLaughlins' agent contacted ASIC on February 19, 2004. The assigned claims adjuster was out of the office and another adjuster fielded the agent's call. The substitute adjuster was "aggressive and hostile" to the agent and denied the agent's request to speak to a supervisor. The substitute adjuster spoke with Ms. McLaughlin the following day and informed her of his view that Harrington was not liable because the well was pumping freshwater when Harrington completed his work and Harrington had no reason to believe the well would eventually pump saltwater. Ms. McLaughlin expressed disagreement with the substitute adjuster's position. The substitute adjuster also suggested other sources may have damaged the plants, including a harsh winter, and stated he did not have evidence the plants were actually dead. Ms. McLaughlin informed the substitute adjuster that they had lost approximately $72,000 in plants. She asked why ASIC had not sent a field claims adjuster to the property. The adjuster responded that ASIC had no intention of doing so. Ms. McLaughlin then promptly sent ASIC another copy of the initial $28,000 invoice, a second invoice for additional damaged plants in the amount of approximately $37,000, and 32 before-and-after photographs accompanied by a written explanation of each photograph.

Two weeks later, the McLaughlins' agent called the original adjuster, who had returned to the office, and expressed frustration with the claim handling. The claims adjuster then contacted Harrington again about the hydrogeologist's report; Harrington informed her he was still waiting for it.

At that time, the adjuster also informed her supervisor that Ms. McLaughlin was unsatisfied with the handling of the claim by the substitute adjuster. The supervisor reviewed the file. He criticized the adjuster for not informing him of the claim earlier, as the dollar value exceeded her authority. He also suggested several lines of investigation. The supervisor expressed his opinion that Harrington was likely liable. The supervisor also suggested the retention of an expert, as well as consultation with an attorney and a local well driller to assist in analyzing liability.

The original adjuster then consulted with a Massachusetts attorney, who reviewed the claims file. The attorney explained that whether Harrington's

work met the appropriate standard of care was a matter for expert testimony. The attorney offered his lay opinion, however, that Harrington had met the standard of care, based on Harrington's own explanation.

On March 16, 2004, Miller, the hydrogeologist, sent a letter to ASIC summarizing his memory of the tests he had performed on his chance visit to the property in April 2003. He also described the possibility of upconing due to over pumping of a well close to saltwater.

In early April 2004, the original adjuster left ASIC on medical leave, and the supervisor transferred the claim to a second adjuster. The second adjuster arranged for an independent claims adjuster to visit the property. On May 18, 2004, the independent adjuster submitted his report documenting damage to plants at the site. He also documented his consultation with an experienced local nurseryman who confirmed the damage had been caused by saltwater produced from the well. The independent adjuster requested authority to retain the nurseryman to prepare an estimate of the cost of the damaged plants, for a fee of $500. ASIC never responded to the request.

The second adjuster left ASIC in early May 2004, and the file was reassigned to a third adjuster. Around that time, the supervisor also left ASIC. In June 2004, the third adjuster decided to deny the claim. The attorney retained by ASIC did not advise the McLaughlins' attorney of the denial, however.

The McLaughlins commenced suit in February 2006 alleging negligence against Harrington, Waterworks and Assurance. Shortly before trial, Waterworks and Assurance each settled the claims against them for $50,000. The case against Harrington proceeded to trial. The jury found Harrington liable and awarded damages of $37,500. The trial judge offset the damage award by the settlement payments from Waterworks and Assurance, and the net award against Harrington was zero dollars.[1]

The 93A Suit

On June 8, 2007, the McLaughlins sent a demand letter to ASIC pursuant to the Consumer Protection Act, G.L. c. 93A, and the unfair claims settlement practices provisions of G.L. c. 176D. Shortly thereafter, the McLaughlins commenced suit against ASIC. After a jury-waived trial, the judge concluded that ASIC failed to conduct a prompt, thorough and objective investigation of the claim. The judge further found that Harrington's liability had become reasonably clear by at least May 2004, but that ASIC failed to make a reasonable offer of settlement until several years thereafter (on the eve of trial). The judge found the McLaughlins were entitled to recovery of their reasonable attorney's fees and expenses in connection with the suit against Harrington. However, the judge declined to award loss of use damages or multiple damages under to G.L. c. 93A.

Liability and Damages Were Reasonably Clear

It is well established in Massachusetts that, when considered together, G.L. c. 93A, §2(a) and c. 176D, § 3(9)(f), require an insurer to promptly make a fair and reasonable offer to settle when liability, encompassing fault and damages, becomes reasonably clear. Whether liability is reasonably clear is objective, determined by "whether a reasonable person, with knowledge of the relevant facts and law, would probably have concluded, for good reason, that the insured was liable to the plaintiff."

The Appeals Court began by affirming the trial judge's determination that Harrington's liability was reasonably clear as of May 2004. The trial judge's determination was supported, in particular, by the independent adjuster's May 18, 2004, letter to ASIC, confirming the plants had been killed or damaged by saltwater from the well installed by Harrington. The McLaughlins' damages were substantiated by invoices totaling more than $66,000. ASIC also had Miller's letter, which highlighted the risk of saltwater infiltration of heavily used wells drilled in close proximity to the ocean. ASIC was previously advised by Harrington that the irrigation system would be used heavily. Moreover, ASIC knew Harrington was aware of the possibility of saltwater infiltration but had failed to advise Waterworks or the McLaughlins of the possibility of upconing or the need for monitoring. ASIC was unreasonable in its acceptance of Harrington's denial of responsibility, in light of its failure to consult an independent expert on the standard of care or the likely cause of contamination of the McLaughlins' well. In light of the available information, a reasonably objective insurer would have concluded that Harrington was liable to the McLaughlins by May 2004.

The Appeals Court dismissed ASIC's two asserted grounds of error. ASIC first contended that Harrington's liability was not established or reasonably clear because the judgment ultimately entered against him was for no monetary damages. The Appeals Court rejected this argument. The question of whether and when an insured's liability becomes reasonably clear is based on an objective assessment of the facts known or available at the time, here, May 2004, independent of a jury's later assessment of liability in a separate trial. Moreover, the jury in the underlying trial did find Harrington negligent and that his negligence caused the McLaughlins' damages, though the ultimate judgment was for zero dollars due to offsets.

Second, ASIC contended that as a matter of law, liability of an insured

[1] A panel of the Appeals Court affirmed the judgment in an unpublished order.

can never be reasonably clear if other potential tortfeasors are apparent. The Appeals Court likewise rejected this position. There was no evidence in the record to suggest that ASIC made any consideration of the potential liability of Waterworks and Assurance in May 2004 or even as the tort suit proceeded. Moreover, that Waterworks and Assurance were ultimately named as defendants in the tort suit several years later and agreed to settlement of the McLaughlins' claims did not excuse ASIC from its statutory obligation to make an offer of settlement at the time Harrington's liability became reasonably clear, in May 2004. The court noted it would be contrary to the goals of G.L. c. 176D and c. 93A — to encourage the settlement of claims — if an insurer could refuse to make an offer of settlement in any case in which another potential tortfeasor might share liability with an insured.

ASIC Failed to Make a Reasonable Investigation

Under G.L. c. 176D, an insurer commits an unfair claim settlement practice when it refuses to pay a claim without conducting a reasonable investigation based upon all available information. G.L. c. 176D, §3(9)(d). The Appeals Court affirmed that ASIC breached its duty to conduct a reasonable investigation by failing to scrutinize Harrington's denial of responsibility and failing "to

take even the most basic steps toward obtaining" an independent assessment of Harrington's potential liability. The court was troubled by ASIC's failure to consult a hydrogeology expert about the cause and foreseeability of saltwater infiltration into the well, despite the ASIC supervisor's recognition of the need for an independent expert analysis. The court characterized ASIC's handling of the claim as "at best inattentive, if not incompetent."

Loss of Use Damages Were Proper Even Though the Judgment in the Underlying Case Assessed No Damages Against the Insured

The trial judge did not award the McLaughlins damages for their loss of use of the funds ASIC should have offered when Harrington's liability was reasonably clear. He reasoned that the judgment in the tort action awarded no damages and thus the McLaughlins never lost use of funds eventually paid by ASIC. The McLaughlins argued this was error, and the Appeals Court agreed.

ASIC was obligated to make a reasonable offer to settle when Harrington's liability became reasonably clear in May 2004. The obligation was not relieved by the potential of other responsible tortfeasors. ASIC's failure to make the required offer deprived the McLaughlins of the use of the funds that should have been offered in settlement, from the time that liability became reasonably clear until the time the McLaughlins were ultimately compensated for their loss. Thus, the McLaughlins were entitled to recover loss of use damages in the form of lost interest from the time the claim should have been paid, May 2004, to the time of judgment, adjusted to account for the settlement payments by Waterworks and Assurance at the time they were made, on the eve of trial.

Attorney's Fees Are Appropriate Actual Damages Where the Insurer's Delay in Settlement Causes a Claimant to Proceed to Trial on the Tort

The Appeals Court affirmed the trial judge's award of attorney's fees incurred by the McLaughlins in prosecution of their claims against Harrington, as damages incurred as a result of ASIC's failure to make a reasonable offer of settlement when liability was reasonably clear. Where an insurer's delay in settling a claim requires a plaintiff to proceed to trial on the tort claim, attorney's fees and expenses incurred in that suit by the plaintiff are recoverable as actual damages caused by the insurer's violation.

Appellate Attorney's Fees Were Appropriate but Multiple Damages Were Not

The McLaughlins argued that the trial judge erred in failing to multiply the damages awarded for ASIC's violation of G.L. c. 93A. Under c. 93A, actual damages are doubled or tripled if the violation of c 93A is knowing, willful or even reckless. The Appeals Court summarily dismissed the McLaughlins' argument, finding no clear error in the trial judge's factual finding that ASIC's violation was not knowing or willful. However, the Appeals Court held that an award of the McLaughlins' appellate attorney's fees was appropriate.

Implications of the Case

The Appeals Court decision highlights the importance of an insurer's obligation to make a reasonable investigation of a claim. The opinion makes clear that the insurer cannot simply rely on an insured's denial of liability. Especially in cases involving technical issues, the insurer best protects its interests by obtaining the opinion of an independent authority in making a determination of liability of its insured. Failure to do so will frequently be a violation of G.L. c. 176D.

Moreover, it cannot be stated categorically that the presence of additional potentially liable tortfeasors renders liability unclear. Rather, whether liability is clear remains a question unique to the facts of each case. Failure to make a prompt offer to settle after liability of an insured becomes reasonably clear may result in an award of attorney's fees in the claimant's prosecution of a claim against the insured. Moreover, it may result in an award of loss of use damages, even if the claimant is eventually compensated in full from other sources. ■

H/O Line on Profit Run While Personal Auto Falters, Finds Fitch

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As a key product in a large number of insurers' underwriting portfolios, unfavorable private passenger auto results can have a significant effect on overall industry performance, explained the report. However, the recent deterioration in auto underwriting performance in most cases has not affected insurance carriers' profitability or capital to a degree that leads to negative rating actions.

Overall personal lines market performance slipped to an underwriting loss in 2015, and midyear 2016 results suggest near-term improvement in performance is unlikely, in Fitch's view. Competitive dynamics in personal lines insurance have created considerable profit challenges for personal lines underwriters, with unrelenting competition among very large market participants.

"Personal lines underwriters face considerable future fundamental challenges as telematics and price segmentation continue to expand, customer buying practices evolve and ride sharing and driverless cars alter vehicle usage and safety — affecting the longer-term product and risk offering of auto insurance," said Jim Auden, managing director at Fitch. ■