SANDBERG PHOENIX

BAD FAITH BLOG

Bad Pleading Bars Bad Faith/ Extra-Contractual Claims

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Propitious and Connacht were co-owned. Propitious owned the building from whom Connacht leased the first floor to operate a restaurant and sports bar. Propitious insured the structure through Badger Mutual Insurance Company and Connacht insured its business through Society Insurance when the building and business had a damaging water loss. After Propitious and Connacht were unable to resolve their insurance claims with Badger and Society, they joined in a suit in which they jointly sued Badger and Society. Society moved to dismiss multiple counts and succeeded in getting those statutory bad faith and extra-contractual counts dismissed without prejudice.

There were numerous disputes between the insureds and their separate insurers as well as between the insurers regarding the full scope of the loss and which insurance company was responsible for paying what portion of the loss. Each insurer paid what it believed it owed to its insured while, at the same time, taking the position that "the other insurer is responsible for payment" of nearly $200,000 in damages. Society moved to dismiss, with prejudice, the Consumer Fraud Act (CFA) claims, the statutory bad faith claim, and the intentional and negligent misrepresentation claims. Society made multiple arguments, but a couple overarching positions were that it owed no duties to Propitious since it did not insure Propitious and that neither Plaintiff was entitled to extra-contractual damages since the case "amounts to nothing more than an insurance coverage dispute between the parties." Although the judge agreed that Society was entitled to have each of the attacked counts dismissed without prejudice, the judge would not dismiss any of the counts with prejudice.

Illinois statutory bad faith claims are based on section 155 of the Illinois Insurance Code. 215 ILCS 5/155. Most likely the court could have resolved the attack on that count based solely upon the federal pleading requirements declared by the Supreme Court in *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). Nevertheless, the court went further citing several Illinois rulings "that an insurer's mere refusal to pay a claim does not constitute breach of the duty of good faith and fair dealing, but rather refusal to pay must be accompanied by 'vexatious, unreasonable, outrageous conduct'." Connacht's complaint alleged that Society engaged in "discussions to attempt to resolve the coverage dispute," investigated the claim, retained a third party adjuster to evaluate portions of the damage, and made payments exceeding $142,000 for the part of the loss "it determined [was] covered under the policy." The judge concluded that such conduct was not "vexatious, unreasonable, outrageous conduct." In addition, the allegations of the complaint showed there was "a bona fide coverage dispute … regarding which items are covered under the policy" making it impossible for Society's conduct to be "vexatious, or unreasonable."

The court also found that the other extra-contractual claims had to be dismissed without prejudice. For example, the court dismissed the intentional misrepresentation claim after concluding that Connacht failed to meet the heightened pleading requirements in Rule 9(b). In federal court, claims of fraud must be alleged with particularity. The judge found that Connacht did not allege "what specific false statements Society made to Connacht when Connacht purchased the policy" and, in addition, failed to allege "any specific false statements made by Society" regarding any alleged misrepresentations regarding "the damages covered" under Society's policy. Furthermore, under Illinois law, "an insurance coverage dispute … cannot form the basis of an intentional misrepresentation claim."

Similarly, no claim for negligent misrepresentation was properly alleged. In addition to failing to plead false statements of material fact made by Society regarding the damages covered, the Illinois economic loss rule also defeated that claim. That rule (also known as the "*Moorman* doctrine") acts to bar "recovery in tort for purely economic losses arising out a failure to perform contractual obligations." Furthermore, Illinois cases previously ruled that "insurance carriers are not in the business of supplying information so have no duty to do so." That rule was another factor that defeated that claim.

In addition, the two Illinois consumer fraud counts were dismissed. The Supreme Court of Illinois had previously held that breaches of "contractual promise[s], without more, [are] not actionable under the CFA." In Illinois, a breach of contract claim will not be allowed to masquerade as a CFA violation. The judge noted that "when a separate tort claim is essentially based on an insurer's failure to pay amounts purportedly owed under an insurance contract, such claims are preempted by contract[] remedies and those found in the Illinois Insurance Code." 215 ILCS 5/155.

The plaintiffs' CFA claims were subject to dismissal because it was based on the "same factual foundation as their breach of contract claims." In addition, the plaintiff's CFA claims were "preempted by § 155 of the Illinois Insurance Code, which 'provides an extracontractual remedy to policyholders whose insurer's refusal to recognize liability and pay a claim is vexatious and unreasonable.'" The court supported that ruling by looking to the Illinois Supreme Court's decision in *Cramer v. Ins. Exch. Agency*, 174 Ill. 2d. 513 (1996). In addition, Propitious was not insured by Society, which prevented Propitious from being a consumer within the meaning of the CFA. Nor could it satisfy the consumer nexus test which enables some non-consumers to prosecute CFA claims.

Although Connacht was able to pursue its contract claims against Society and Badger had to defend against the claims asserted by Propitious, Society was successful in getting the statutory bad faith and extra-contractual claims against it dismissed without prejudice. This ruling serves as a good defense roadmap for insurers sued in federal court on first party claims seeking extra-contractual damages.