

# SURVEY OF RECENT DEVELOPMENTS IN INSURANCE LAW

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## INTRODUCTION

During each of the past few survey years, at least one decision on insurance law has deserved special attention. However, during the most recent survey period,<sup>1</sup> the Indiana appellate courts failed to address any insurance decisions that will have a monumental impact on all practitioners. Nevertheless, a number of significant cases were decided, which cover many areas including automobile, homeowners, commercial liability, health, and medical insurance policies. This Article discusses these decisions and their effect on the practice of insurance law.

## I. AUTOMOBILE INSURANCE CASES

### A. *Permissive Use*

One of the more interesting cases from the survey period involved the question of a truck driver's permissive use of an automobile after consuming alcohol. In *Warner Trucking, Inc. v. Carolina Casualty Insurance Co.*,<sup>2</sup> the owner of a trucking company expressly forbid all truck drivers from consuming alcohol on the days they drove company trucks.<sup>3</sup> One of the company's drivers consumed alcohol at a fellow employee's party on the evening before he was to begin an early morning journey. The driver left the party and was dropped off at his truck to sleep before leaving on the trip. During the evening, the truck driver drove away and collided with another vehicle, injuring the occupants.<sup>4</sup>

The injured victims filed a lawsuit against the driver and his employer.<sup>5</sup> The trucking company's liability insurance carrier filed a separate declaratory judgment lawsuit to disclaim coverage for the employee. The two cases were consolidated for resolution. For both the personal injury lawsuit and the declaratory judgment action, the supreme court addressed issues concerning permissive use of the truck by the driver.<sup>6</sup>

Warner Trucking filed a Motion for Summary Judgment in the victims' personal injury lawsuit, contending that the driver's action of driving the vehicle after consuming alcohol violated the company's rule prohibiting such conduct. Thus, the trucking company argued that it could not be responsible because the driver was not acting within the scope of his employment at the time of the

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1. The survey period for this Article is approximately September 1, 1997 to August 1, 1998.

2. 686 N.E.2d 102 (Ind. 1997).

3. *See id.* at 104-05.

4. *See id.* at 105.

5. *See id.* at 104.

6. *Id.* at 105, 107.

accident.<sup>7</sup>

The supreme court disagreed with the trucking company's argument as a matter of law.<sup>8</sup> While the supreme court acknowledged that the driver's behavior in violating the rule is a consideration in determining "scope of employment," it is not solely determinative.<sup>9</sup> The key to determining scope of employment is whether the employee's action benefits or serves his employer.<sup>10</sup> If the employee's action, even if in violation of the employer's rules, provides any benefit to the employer, then a factual issue remains as to whether the employee was acting within the scope of employment.<sup>11</sup>

The employer's liability insurance company also filed a Motion for Summary Judgment on the question of insurance coverage for the driver.<sup>12</sup> Specifically, the insurer argued that in order for the driver to qualify as an "insured," he must be operating the vehicle with permission.<sup>13</sup> Because the company expressly forbid operating a truck after consuming alcohol, the driver did not have permission and was not an insured.<sup>14</sup>

The supreme court agreed with the insurer's argument.<sup>15</sup> Unlike the "scope of employment" issue, the court found the driver's violation of the company's prohibition to be determinative of his permission:

When the owner of a vehicle places express restrictions on its use by others, the focus is not on whether the operator deviated from the contemplated use; the determinative question is whether *the operator's use of the vehicle was restricted in the first instance*. In a coverage dispute, permissive use cannot be implied when an express restriction on the scope of permission prohibits the use at issue.<sup>16</sup>

Thus, the driver did not have permission and did not qualify for insurance coverage under his employer's policy.<sup>17</sup>

### *B. Resident of Household*

With many forms of convenient transportation available in today's society,

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7. *See id.* at 105.

8. *Id.*

9. *Id.*

10. *See id.*

11. *See id.* at 105-06; *see also* Eagle Motor Lines, Inc. v. Galloway, 426 N.E.2d 1322, 1325-26 (Ind. Ct. App. 1981).

12. *See Warner Trucking*, 686 N.E.2d at 106.

13. *See id.* at 106. The language of the policy defined an "insured," in relevant part, as "[a]nyone . . . while using with your permission a covered truck you own, hire or borrow." *Id.*

14. *See id.*

15. *Id.* at 107.

16. *Id.* (quoting State Farm Mut. Auto. Ins. v. Gonterman, 637 N.E.2d 811, 814 (Ind. Ct. App. 1994) (emphasis in original)).

17. *Id.*

people often become transient in their living arrangements. Thus, a common question focuses on where a person resides for purposes of determining insurance coverage.<sup>18</sup> This question is addressed in *Chance v. State Auto Insurance Cos.*<sup>19</sup>

A student's family moved from Marion to Fort Wayne. The student had difficulties with the Fort Wayne school, so his parents sent him to stay with his brother and attend the local school in Marion.<sup>20</sup> In order for the student to attend the Marion school without paying tuition, the parents completed an agreement that stated, in part, that the main reason for the student's move was not so he could attend the Marion school.<sup>21</sup>

The student was killed while riding in a car with an uninsured driver. The student's estate received uninsured motorist benefits from his brother's insurance policy, but also sought to acquire uninsured motorist coverage under his parents' policy.<sup>22</sup> In order for coverage to be available under the parents' policy, the student needed to be "a resident of [the parents'] household."<sup>23</sup>

The court of appeals affirmed the trial court's grant of summary judgment in favor of the insurer, by concluding that the student was not a "resident" of the parents' household at the time of his death.<sup>24</sup> While the court acknowledged that the interpretation of "resident" for an insurance policy is to be given a broad meaning, the court determined that the evidence prevented a finding that the student had more than one residence.<sup>25</sup> The parents were estopped from arguing that the student had two residences so that he could attend school in Marion, when they had executed an agreement that contradicted this argument.<sup>26</sup>

Unlike decisions by other courts,<sup>27</sup> this ruling holds that the student did not have two residences. A dissenting opinion argued that the student had two residences, because Indiana recognizes that a student remains a part of his parents' household while away for educational purposes.<sup>28</sup> However, the dissent ignores the parents' execution of an agreement which expressly stated the student was not living with his brother to attend school. This fact distinguishes the

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18. In last year's survey period, the decision in *Erie Insurance Exchange v. Stephenson*, 674 N.E.2d 607 (Ind. Ct. App. 1996), addressed this same issue. See Richard K. Shoultz, 31 IND. L. REV. 695, 701 (1998).

19. 684 N.E.2d 569 (Ind. Ct. App. 1997), *trans. denied*, 698 N.E.2d 1187 (Ind. 1998).

20. See *id.* at 570.

21. The agreement specifically provided that "[t]he student was placed with the custodian by the student's parent(s). The custodian is supporting and caring for the student. *The student was not placed with the custodian for the primary purpose of attending school in the school corporation of the custodian's residence.* *Id.* at 570 n.1 (emphasis added).

22. See *id.* at 570.

23. *Id.*

24. *Id.* at 571.

25. *Id.*

26. See *id.*

27. See Shoultz, *supra* note 18, at 701.

28. *Chance*, 684 N.E.2d at 572 (Robertson, J., dissenting). The dissenting judge cited a number of cases which support this rationale. *Id.* at 571-72.

*Chance* case from other decisions which concluded that an insured may have more than one residence for purposes of identifying insurance coverage.

*C. Interpretation of Auto Repair Business Exclusion*

Personal automobile insurance policies are generally intended to provide liability coverage for the named insured and persons he permits to drive his vehicle. However, one issue is how far that coverage should extend when the insured entrusts his automobile to a repair shop. The question is addressed in *Barga v. Indiana Farmers Mutual Insurance Group, Inc.*<sup>29</sup>

The insured took his vehicle to a dealership for repair.<sup>30</sup> The dealership's mechanic could not discover the problem and began to drive the truck on personal endeavors in hopes of identifying what was wrong with the truck.<sup>31</sup> One evening, while the mechanic was driving the vehicle for personal use, he was involved in a serious automobile accident. The injured victim filed a lawsuit against the mechanic and the dealership to recover for personal injuries. The trial court entered judgment in favor of the victim, which exhausted the insurance coverage available to the dealership and mechanic.<sup>32</sup> The injured victim then sought to acquire additional damages from the vehicle owner's policy.<sup>33</sup> The insurance company for the owner sought to deny coverage based upon a provision which excluded coverage for "bodily injury and property damage arising out of auto business operations."<sup>34</sup>

In a split decision, the appellate court reversed the granting of summary judgment for the insurance company.<sup>35</sup> The court first found that the victim was not judicially estopped from arguing that her injuries did not "arise out of the business operations" at the time of the accident.<sup>36</sup> The victim initially argued that the mechanic was "in the course of his employment" in order to establish liability against the dealership and to obtain the dealership's insurance coverage.<sup>37</sup> However, the victim contended that her present position, that her injuries did not "arise out of business operations," was not inconsistent with her initial position because the phrases "in the course of" and "arising out of" are not synonymous.<sup>38</sup>

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29. 687 N.E.2d 575 (Ind. Ct. App. 1997), *trans. denied*, 698 N.E.2d 1193 (Ind. 1998).

30. *See id.* at 576.

31. *See id.* There is no mention by the court as to whether the insured consented to the mechanic driving the vehicle for personal use.

32. *See id.*

33. *See id.*

34. The exact language of the exclusion stated: "Bodily injury or property damage arising out of auto business operations. But, coverage does apply to the ownership, maintenance, or use of your insured car in auto business operations by you, a relative, or anyone associated with or employed by you or a relative in the business." *Id.* at 577.

35. *Id.* at 579.

36. *Id.* at 577.

37. *See id.*

38. *See id.*

The court agreed with the victim.<sup>39</sup>

After interpreting the policy, two judges voted to reverse the summary judgment because factual issues existed preventing summary judgment.<sup>40</sup> The mechanic's operation of the vehicle involved both personal and business use.<sup>41</sup> Consequently, whether the accident arose out of auto business operations must be addressed by the trier of fact.<sup>42</sup>

This case amply demonstrates how resolution of an insurance coverage question can be fact sensitive. The mechanic would not have had the vehicle but for his need to complete a repair which is part of a business operation. However, at the time of the accident, a factual uncertainty remained as to whether the mechanic's venture was related to business because he was using the vehicle for personal use.

#### *D. Bad Faith on Uninsured Motorist Claim*

With Indiana's judicial recognition that an insured may pursue a claim for bad faith by his insurance company in the handling of a claim,<sup>43</sup> a practitioner representing an insured may allege that an insurance company has engaged in bad faith, without any rational basis upon which to base the claim. The Indiana Court of Appeals addressed such a situation, where the insurance company clearly did not act in bad faith in addressing a claim, in *Becker v. American Family Insurance Group*.<sup>44</sup>

The insured sustained personal injuries in an automobile accident with an uninsured motorist.<sup>45</sup> The insured submitted an uninsured motorist claim to his own carrier, which was initially denied because the insurance company believed the policy had been canceled. Upon realizing that the cancellation was erroneous, the insurance company reinstated the policy and investigated the accident.<sup>46</sup>

After the investigation was completed, the insurance company again denied the claim. The company believed the insured was greater than fifty percent at fault, which prohibited recovery under the policy.<sup>47</sup> The insured filed suit against the insurer seeking uninsured motorist coverage and alleging that the insurer acted in bad faith by denying the claim.

The trial court bifurcated the uninsured motorist claim from the claim for bad faith.<sup>48</sup> A jury heard the evidence and returned a verdict for the insured, but

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39. *Id.*

40. *Id.* at 579 (Sullivan, J., concurring & Gerrard, J., dissenting).

41. *See id.*

42. *See id.*

43. *See Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 519 (Ind. 1993).

44. 697 N.E.2d 106 (Ind. Ct. App. 1998).

45. *See id.* at 107.

46. *See id.*

47. *See id.*

48. *See id.*

assessed the insured's comparative fault at forty-five percent.<sup>49</sup> As a result, the insurer filed a Motion for Summary Judgment arguing that, as a matter of law, the insurance company did not act in bad faith.<sup>50</sup> The trial court granted summary judgment for the insurance company, which was later affirmed on appeal.<sup>51</sup>

The appellate court reiterated the well-established principal that an insurance company's right to dispute a claim is not tantamount to bad faith:

[A] good faith dispute about the amount of a valid claim or about whether the insured has a valid claim at all will not supply the grounds for a recovery in tort for the breach of the obligation to exercise good faith. This is so even if it is ultimately determined that the insured breached its contract. That insurance companies may, in good faith, dispute claims, has long been the rule in Indiana.<sup>52</sup>

The jury's ultimate determination that the insured was forty-five percent at fault clearly demonstrated the difficulty of determining the insured's fault.<sup>53</sup> Because the jury's verdict was close to the insurance company's assessment of comparative fault, the appellate court found, as a matter of law, that the insurer did not act in bad faith.<sup>54</sup>

This case emphasizes that insurance companies *do not* engage in bad faith, merely by disagreeing with the insured over the value or liability assessment of a claim. Insurance companies possess a "right to disagree," without fear that they have engaged in bad faith. Practitioners who represent insureds should be mindful of this decision and refrain from making unsubstantiated allegations of bad faith against an insurance company. Instead, a claim for bad faith should be used only when insurance companies engage in more egregious behavior than disputing the value of a claim.

#### *E. Assignability of Bad Faith Action*

In a case of first impression, the Indiana Court of Appeals determined that a claim for punitive damages was assignable in *Allstate Insurance Company v. Axsom*.<sup>55</sup> The plaintiff sustained serious injuries in an automobile accident.<sup>56</sup> The defendant possessed limits of \$50,000 from his insurer. At trial, the plaintiff offered to settle the case for policy limits but the insurance company, acting on behalf of the defendant, rejected the offer. The jury returned with a verdict in favor of the plaintiff for \$80,500, which was in excess of the available insurance

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49. *See id.*

50. *See id.*

51. *Id.* at 108.

52. *Id.* (quoting *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 520 (Ind. 1993)).

53. *Id.*

54. *Id.*

55. 696 N.E.2d 482 (Ind. Ct. App. 1998).

56. *See id.* at 484.

coverage.<sup>57</sup>

The defendant assigned to the plaintiff any rights which the defendant possessed against the insurance company.<sup>58</sup> The plaintiff asserted that the insurance company acted in bad faith for failing to settle within policy limits and sought punitive damages and attorney fees. After the trial court granted summary judgment to the insurance company on the plaintiff's attempt to recover punitive damages, the plaintiff appealed.<sup>59</sup>

The Indiana Court of Appeals focused on the ability of a party to assign to another a claim for punitive damages. While the court recognized Indiana's rule against assigning causes of actions for personal injuries,<sup>60</sup> the court determined that a claim for punitive damages could be assigned because it was a claim for property damage rather than for personal injury.<sup>61</sup> The court also relied on an Arizona Court of Appeals decision, which refused to permit recovery under an assignment for personal injury damages such as "pain and suffering, embarrassment, mental anguish and humiliation."<sup>62</sup> Instead, the damages were limited to the pecuniary loss of the insured—the excess judgment—as well as punitive damages.<sup>63</sup>

In deciding that a claim for punitive damages is assignable, the court supported its decision by noting that permitting this assignment would serve the purpose of "forc[ing] insurance companies to deal in good faith with their insureds as opposed to unreasonably exposing them to personal liability if a jury were to return a verdict in excess of policy limits."<sup>64</sup> Thus, despite the court's statement in a footnote that it was not addressing whether a claim for an insurer's bad faith refusal to settle is assignable, the court seems to have determined that the tort of bad faith is assignable based on the purpose behind awarding punitive damages.<sup>65</sup> While it remains unclear whether an insured may assign a claim for the tort of bad faith, it would appear the court is leaning toward permitting such an assignment.

#### *F. Misrepresentation in Application for Insurance*

Although a number of cases address the effect of material misrepresentations

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57. *See id.*

58. *See id.*

59. *See id.*

60. *Id.* at 485. *See Picadilly, Inc. v. Raikos*, 582 N.E.2d 338, 340 (Ind. 1991).

61. *Axsom*, 696 N.E.2d at 485.

62. *Id.* (quoting *Clearwater v. State Farm Mut. Auto. Ins. Co.*, 780 P.2d 423, 427 (Ariz. Ct. App. 1989), *vacated in part by* 792 P.2d 719 (Ariz. 1990)).

63. *Id.*

64. *Id.* at 486.

65. In its footnote, the court observed that "[n]either [the plaintiff] nor [the insurer] discusses in their briefs whether a tort action for an insurer's bad faith failure to settle is assignable. We reserve for another day a detailed discussion of this issue. For the sake of argument we assume its assignability." *Id.* at 484 n.1.

by an insured in the acquisition of insurance, the Indiana Supreme Court, in a well-written opinion, discussed the issue in *Colonial Penn Insurance Co. v. Guzorek*.<sup>66</sup> A wife filled out a policy application, but did not disclose that her husband's driver's license had been suspended or that her husband had continued to drive.<sup>67</sup> While he was driving his wife's vehicle, the husband was involved in an automobile accident.

Before addressing the misrepresentation issue, the court discussed whether the vehicle driven by the husband was covered under the policy.<sup>68</sup> The wife had acquired the new vehicle twenty-nine days before the accident.<sup>69</sup> The couple argued that coverage existed because the vehicle was either an "additional"<sup>70</sup> or "replacement"<sup>71</sup> vehicle as defined under the policy.

The court determined the vehicle did not fall within either of these provisions.<sup>72</sup> Because the wife did not notify the insurer of the vehicle's acquisition within the first thirty days after purchase, the wife did not follow the policy requirements that trigger coverage.<sup>73</sup> The court refused to find that coverage automatically existed for the thirty-day period during which the insured failed to notify the insurer that she had purchased a car.<sup>74</sup>

Likewise, the court also refused to find that the new vehicle qualified as a "replacement" automobile.<sup>75</sup> Because the wife never actually disposed of another vehicle, the court found that the new vehicle did not "replace" another car and denied coverage.<sup>76</sup>

Next, the court focused upon the misrepresentation in the policy application. The parties did not dispute that the wife made a misrepresentation by not including her husband's driving suspension as well as his continued driving.<sup>77</sup>

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66. 690 N.E.2d 664 (Ind. 1997).

67. *See id.* at 666.

68. *Id.* at 668.

69. *See id.*

70. The "additional" car provision stated in relevant part:

If We insure all your private passenger autos . . . at the time You get the additional auto or truck, We'll automatically consider it to be listed on your Declarations Page. It will have the same coverages as your other autos. For the coverages to apply, however, You must notify us within 30 days after getting the vehicle . . . and pay an additional premium.

*Id.* (emphasis omitted).

71. The policy defined "replacement" car as: "You may replace a listed auto with another private passenger auto, during the policy period. If You do, We'll automatically consider the replacement to be listed. The coverages You bought for your former auto will apply to the replacement." *Id.* at 670. (emphasis omitted).

72. *Id.* at 671.

73. *See id.* at 669.

74. *Id.* at 670.

75. *Id.* at 670-71.

76. *Id.*

77. *See id.* at 673.



Likewise, because the husband was automatically covered under the wife's policy, the misrepresentation was "material" because the insurer's underwriting guidelines prohibited offering coverage to applicants in this situation.<sup>78</sup>

The court focused on whether the insurer could rescind the policy based upon a material misrepresentation of the insured.<sup>79</sup> The court first concluded that the public policy concerns under Indiana's Financial Responsibility Act,<sup>80</sup> permitted rescission for material misrepresentations.<sup>81</sup> The court also determined that the insurance company could rescind the policy because of the material misrepresentations made by the wife in applying for insurance.<sup>82</sup> Either as a spouse or because of his driving record, the husband's absence from the application was material such that the insurance company would not have written the policy had it known of his presence or driving record.<sup>83</sup>

## II. HOMEOWNERS AND COMMERCIAL LIABILITY INSURANCE CASES

### A. Cancellation of Policy

One of the most significant decisions during this survey period focuses on an insurance company's attempt to cancel a homeowners policy by certified mail, which was never claimed by the insured. In *Conrad v. Universal Fire & Casualty Insurance Co.*,<sup>84</sup> the Indiana Supreme Court concluded that such an attempt did not provide adequate cancellation notice to the insured.<sup>85</sup>

The insurance company accepted an application for homeowners insurance coverage on the insured's property.<sup>86</sup> However, after inspecting the property, the insurance company decided to cancel the policy; cancellation was permitted "for

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78. *See id.*

79. *Id.* at 672-74. The court summarized earlier decisions by stating:

In sum, [*Automobile Underwriters, Inc. v. Stover*, 268 N.E.2d 114 (Ind. Ct. App. 1971)] permitted rescission based on material misrepresentations, [*American Underwriters Group, Inc. v. Williamson*, 496 N.E.2d 807 (Ind. Ct. App. 1986)] held that voiding coverage is never permissible in light of changes in the [Financial Responsibility Act, IND CODE §§ 9-25-44-1 to -11 (1998)], [*Motorists Mutual Insurance Co. v. Morris*, 654 N.E.2d 861 (Ind. Ct. App. 1995)] held that the insurer could void coverage so long as the third party victim had uninsured motorist protection, and [*Pekin Insurance Co. v. Super*, 912 F.Supp. 409 (S.D. Ind. 1995)] attempted a compromise by allowing the insurer to deny coverage only above the minimum liability amounts specified by the Act.

*Id.* at 672.

80. IND. CODE §§ 9-25-4-1 to -11 (1998).

81. *Colonial Penn Ins. Co.*, 690 N.E.2d at 672.

82. *Id.* at 673.

83. *See id.*

84. 686 N.E.2d 840 (Ind. 1997).

85. *Id.* at 841.

86. *See id.*

any reason” within the first sixty days. In canceling the policy, the insurance company sent notice to the insured via certified mail, with return receipt requested.<sup>87</sup> The notice was returned to the insurance company as “unclaimed.”<sup>88</sup>

Subsequently, a fire occurred at the insured’s property.<sup>89</sup> The insureds notified their insurance company and discovered their policy had been canceled. The insureds filed suit against the insurance company after their claim was denied. The insurance company argued that cancellation notice was proper and effective.<sup>90</sup> The trial court and the court of appeals<sup>91</sup> agreed with the insurance company.<sup>92</sup> However, the Indiana Supreme Court found use of certified mail insufficient in providing cancellation notice to an insured when the certified letter is returned undelivered.<sup>93</sup>

The court observed that certified mail requires the signature of the recipient.<sup>94</sup> Due to the growing number of families in which all adults work during mail delivery hours, it is less likely a postal worker will be able to obtain a signature.<sup>95</sup> Instead, the court found the use of regular mail, which was authorized by the policy as a means to send cancellation notice, is more effective in providing notice to the insured.<sup>96</sup> If regular mail is used and the notice is not returned, then it is presumed that the insured received the notice.<sup>97</sup> For the insured to prevent cancellation, he must rebut the presumption.<sup>98</sup>

This case demonstrates that as long as the policy authorizes its use, insurers should send cancellation notices via regular mail to create the presumption of receipt. Failure to do so may make it more difficult for the insurance company to establish that the policy was canceled.

### *B. General Liability Coverage for Faulty Workmanship Claim*

Contractors are often sued for alleged faulty workmanship. Contractors usually purchase general liability insurance coverage and believe that it will cover all claims that may be asserted against them, including claims for faulty workmanship. However, in *R.N. Thompson & Associates, Inc. v. Monroe Guaranty Insurance Co.*,<sup>99</sup> an informative reading for contractors and their

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87. *See id.* The policy permitted cancellation by stating “[p]roof of mailing shall be sufficient proof of notice.” *Id.* at 842.

88. *See id.* at 841.

89. *See id.*

90. *See id.*

91. 670 N.E.2d 936 (Ind. Ct. App. 1996), *reversed*, 686 N.E.2d 840 (Ind. 1997).

92. *See Conrad*, 686 N.E.2d at 841.

93. *Id.*

94. *Id.* at 842.

95. *See id.*

96. *Id.* at 843.

97. *See id.*

98. *See id.*

99. 686 N.E.2d 160 (Ind. Ct. App. 1997), *trans. denied*, 698 N.E.2d 1191 (Ind. 1998).

counsel, a general liability policy was found not to cover claims for the repair or replacement of faulty workmanship.<sup>100</sup>

A contractor developed and built an addition to a housing development.<sup>101</sup> The homeowners association sued the contractor after observing that the plywood used for the roof decking had deteriorated. The association sought damages for the cost to repair or replace the defective workmanship. The contractor's insurance companies denied the claim because it was for an economic loss and did not constitute "property damage," and it did not arise from an "occurrence" as defined by the policy.<sup>102</sup>

The appellate court upheld the trial court's grant of the insurance companies' Motions for Summary Judgment on a lack of coverage obligation.<sup>103</sup> The court first concluded that a claim for the repair and replacement of an insured's faulty workmanship does not involve "physical injury to tangible property," which is required in order for "property damage" to trigger a coverage obligation.<sup>104</sup> In a quote often relied upon, but still offering simple and complete analysis, the court stated:

[T]he costs attendant upon the repair or replacement of the insured's own faulty work is part of every business venture and is a business expense to be borne by the insured-contractor in order to satisfy customers. It is a business risk long excluded by comprehensive liability policies. Another form of risk in the insured-contractor's line of work is injury to people and damage to other property caused by the contractor's negligence or defective product. It is this risk which the policy in question covers.<sup>105</sup>

The court also concluded that the contractor's work did not establish an "occurrence" as required by the policy.<sup>106</sup> The policy defined an "occurrence" in general terms as an "accident" on the part of the insured.<sup>107</sup> Because the homeowners association's lawsuit against the contractor was for breach of contract arising out of faulty workmanship by the contractor, the conduct at issue was not an "accident" and did not qualify as an "occurrence."<sup>108</sup> The court noted that a typical general liability policy "does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident."<sup>109</sup>

This case fills a void in Indiana law concerning claims under a general liability policy for faulty workmanship. Formerly, Indiana case law addressed

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100. *Id.* at 165.

101. *Id.* at 161.

102. *See id.*

103. *Id.* at 165.

104. *Id.* at 163.

105. *Id.* at 163 (quoting *Indiana Ins. Co. v. DeZutti*, 408 N.E.2d 1275, 1279 (Ind. 1980)).

106. *Id.* at 165.

107. *See id.* at 164.

108. *See id.* at 165.

109. *Id.* (quoting *DeZutti*, 408 N.E.2d at 1279).

policy exclusions,<sup>110</sup> which presumed that an initial coverage obligation is owed until the exclusion is applied. Now, in addition to asserting that coverage is excluded under the “builders risk” exclusions contained in a policy,<sup>111</sup> practitioners can rely on case law establishing that no insurance coverage is owed for claims of faulty workmanship because there is no “property damage” or “occurrence” necessary to trigger coverage.

*C. Coverage for Wife’s Knowledge of Husband’s Sexual Molestations*

In *Frankenmuth Mutual Insurance Co. v. Williams*,<sup>112</sup> a girl was sexually molested by her babysitter’s husband.<sup>113</sup> Initially, the girl sued only the husband, but later amended her complaint to add a claim that the wife “negligently” failed to supervise the girl during the time she was in the wife’s home.<sup>114</sup> Because the insurance company denied coverage to the husband and wife, it did not provide any counsel to them under a reservation of rights or file any declaratory judgment action disclaiming coverage.<sup>115</sup>

After previously reaching the Indiana Supreme Court on other grounds,<sup>116</sup> the supreme court addressed whether the insurance company was collaterally estopped from denying coverage after the wife entered into a consent judgment in the victim’s negligence lawsuit.<sup>117</sup> The insurance company argued that no coverage was available to the wife because the molestation consisted of “intentional” conduct by her husband, which is excluded under the policy.<sup>118</sup> However, the supreme court found that the insurance company could not allege the injuries were caused by intentional conduct because the consent judgment was based on an agreement that the wife’s liability was negligent and not intentional conduct.<sup>119</sup>

Also, the insurance company argued that negligence occurred while the wife engaged in a “babysitting service,” which is also excluded from coverage.<sup>120</sup> The

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110. See *DeZutti*, 408 N.E.2d at 1278).

111. The policy usually contains exclusions for “your work” or “your product” which are specifically designed for contractor situations. See *id.* at 1277.

112. 690 N.E.2d 675 (Ind. 1997).

113. *Id.* at 676.

114. See *id.* at 676-77.

115. Such alternatives are available and should be pursued by an insurance company where any uncertainty exists about the availability of coverage. See *Liberty Mut. Ins. Co. v. Metzler*, 586 N.E.2d 897, 902 (Ind. Ct. App. 1992).

116. See *Frankenmuth Mut. Ins. Co. v. Williams*, 645 N.E.2d 605, 607 (Ind. 1995) (determining that the insurance company possessed notice of the claim by receiving a subpoena for the insurance claim file and, therefore, is collaterally estopped from denying liability).

117. *Williams*, 690 N.E.2d at 678.

118. Under the policy, coverage was excluded for any injuries “caused intentionally by or at the direction of any insured.” *Id.* at 678 (emphasis added).

119. *Id.* at 678.

120. *Id.*

supreme court reversed the summary judgment for the victim on the coverage issue, so that the insurance company could litigate that fact issue—whether the wife was engaged in a business venture.<sup>121</sup> The court found disputed facts which needed to be addressed by the trier of fact, and that the consent judgment did not prevent the insurance company from litigating this particular issue.<sup>122</sup>

This case is one of many which demonstrates the risks insurers face when they fail to seek a declaratory judgment on the issue of coverage or fail to provide an insured with a defense under a reservation of rights. Where coverage does not appear to exist, the insurer should seek a judicial declaration that no coverage exists, so that collaboration between the victim and insured cannot foreclose the insurer from pursuing its coverage defenses.

#### *D. Sexual Harassment Claim in a General Liability Policy*

An increasingly frequent situation focuses on whether coverage exists under a general liability policy for claims of sexual harassment. In *General Accident Insurance Co. of America v. Gastineau*,<sup>123</sup> a federal district court, interpreting specific policy language, found that such coverage existed.<sup>124</sup> A male employee alleged that company employees engaged in “hostile work environment” sexual harassment.<sup>125</sup> The company’s insurer sought to deny the company’s insurance claim by relying on a “co-employee” exclusion, as well as contending that no “bodily injury” or “occurrence” existed as required by the policy.<sup>126</sup>

The court had no difficulty disposing of the insurer’s reliance upon the “co-employee” exclusion because the exclusion had been modified by an endorsement and the insurance company did not address the issue in its brief.<sup>127</sup> In addressing whether “bodily injury” was alleged to trigger coverage, the court found no direct allegations of physical contact to the victim.<sup>128</sup> However, the court believed that the simple allegation of a “hostile work environment,” as a form of sexual harassment, is sufficient to allege “bodily injury” such that the insurance company should have provided coverage:

Not every hostile work environment case necessarily involves physical contact, but we believe that bodily contact is sufficiently inherent in hostile work environment claims that, without conducting any reasonable investigation into [the plaintiff’s] allegations, [the insurance company’s] duty to defend [the insured] was triggered.<sup>129</sup>

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121. *Id.* at 681.

122. *Id.*

123. 990 F.Supp. 631 (S.D. Ind. 1998).

124. *Id.* at 638.

125. *See id.* at 634.

126. *See id.* at 632.

127. *Id.* at 633.

128. *Id.* At trial, however, the victim testified that physical contact occurred. *Id.* at 635.

129. *Id.* at 635.

The court also found that the insured established that an “occurrence” existed such that a coverage obligation was owed.<sup>130</sup> Specifically, the court determined that a claim for hostile work environment involved a negligence standard of conduct by the insured as opposed to an intentional standard of conduct:

In sum, the Seventh Circuit has made clear that, in order for an employer to discriminate against an employee who objectively and subjectively has been the victim of a hostile work environment, it must have known or should have known about the discrimination. . . . Because the standard for employer liability for hostile work environment claims is negligence, we hold that [the plaintiff’s] hostile work environment claim against [the insured] qualifies as an occurrence pursuant to its insurance policy.<sup>131</sup>

Therefore, practitioners facing a coverage question for discrimination claims must look closely to the language of the policy. While general liability policies are not designed for discrimination claims, coverage may exist if the policy does not have the appropriate exclusionary language.

*E. Standards for Bad Faith by Insurer in Handling Fire Loss Claim*

Since the Indiana Supreme Court established the tort of bad faith by an insurer in handling an insured’s claim,<sup>132</sup> attorneys have been uncertain of the elements necessary to show bad faith. Unfortunately, many attorneys representing insureds have threatened to pursue bad faith actions against insurers whenever a disagreement exists between the insured and insurer.<sup>133</sup> Fortunately, in *Colley v. Indiana Farmers Mutual Insurance Group*,<sup>134</sup> the court clarified the elements necessary to show that an insurer engaged in bad faith.

A fire loss occurred at the insured’s home, which was investigated by the insurer.<sup>135</sup> The insured contended that the insurer engaged in bad faith by concealing its arson investigation of the insured’s fire loss and that the deception prevented the insured from preserving evidence to support his claim.<sup>136</sup> The trial court granted summary judgment to the insurer on the bad faith claim, and the insured appealed.<sup>137</sup>

The appellate court affirmed the trial court’s summary judgment.<sup>138</sup> The court held that the mere negligent handling of a claim by an insurer did not

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130. *Id.* at 638.

131. *Id.*

132. *See* *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 519 (Ind. 1993).

133. An insurance company possesses a right to disagree with its insured on liability or damages without committing bad faith. *Id.* at 520. *See also supra* Part I.D.

134. 691 N.E.2d 1259 (Ind. Ct. App. 1998).

135. *See id.* at 1260.

136. *See id.*

137. *See id.*

138. *Id.*

amount to bad faith.<sup>139</sup> Instead, the court found that the insured must show “an element of culpability” on the part of the insurer.<sup>140</sup> In discussing the culpability element, the court stated:

As an example of the additional evidence needed, the Indiana Supreme Court noted that “the lack of a diligent investigation alone is not sufficient to support an award. On the other hand, for example, an insurer which denies liability knowing that there is no rational, principled basis for doing so has breached its duty.”<sup>141</sup>

In the *Colley* case, sufficient evidence was shown of the insurer’s belief that it had notified the insured it was pursuing an arson investigation.<sup>142</sup>

This case demonstrates the significance of “culpable” conduct on the part of the insurer to finding a bad faith action. A mere dispute or disagreement between the insured and insurer is insufficient.

#### *F. Meaning of “Suit” and “Damages” in Environmental Claim*

*Hartford Accident & Indemnity Co. v. Dana Corp.*<sup>143</sup> is a complicated case, but with important rulings by the court. Due to the complexity of the facts and issues, it is only briefly discussed in this Article. However, if faced with an environmental claim, this case is a “must read” for practitioners.

The insured manufactured automotive parts, with many of its facilities in Indiana.<sup>144</sup> It purchased a number of primary and excess insurance policies from different insurers.<sup>145</sup> Various lawsuits by government agencies and others were filed against the insured to recover environmental cleanup costs.<sup>146</sup> The insured submitted claims for coverage under its policies with the various insurers which were, for the most part, denied.<sup>147</sup> Consequently, the insured filed a declaratory judgment action seeking coverage.<sup>148</sup>

The appellate court addressed a number of issues. First, the court faced a choice of law question based on the national scope of the insured’s operations and decided Indiana was the proper venue.<sup>149</sup> Secondly, the court concluded that the term “suit” as contained in the policy was ambiguous such that the

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139. *Id.* at 1261.

140. *Id.*

141. *Id.* (quoting *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515, 520 (Ind. 1993)).

142. *See id.*

143. 690 N.E.2d 285 (Ind. Ct. App. 1997), *trans. denied*, 698 N.E.2d 1191 (Ind. 1998).

144. *See id.* at 289.

145. *See id.* at 288.

146. *See id.*

147. *See id.*

148. *See id.*

149. *Id.* at 291. The court concluded that Indiana law applied based upon the “most intimate contacts” test. *Id.*

governmental actions are covered under the primary insurers' policies.<sup>150</sup> The court stated, "We agree with those courts which have found coercive and adversarial administrative proceedings to be 'suits.' To decide otherwise would encourage insureds to not cooperate with governmental agencies, thus running the risk of huge fines, punitive damages, and delay in remediating environmental pollution."<sup>151</sup> The court also concluded that the term "damages" in a commercial general liability policy includes "[Environmental Protection Agency] or state-mandated cleanup and response costs."<sup>152</sup>

This case is significant in defining the scope of coverage for administrative proceedings. Most proceedings result in costly legal fees and costs and now fall within the duty to defend that exists under the policy.

### III. HEALTH AND MEDICAL INSURANCE

#### A. Subrogation Under ERISA of Uninsured Motorist Benefits

Generally, a health plan governed by the Employee Retirement Income Security Act ("ERISA")<sup>153</sup> creates instant uncertainty when a personal injury claim is involved. In *Southern Indiana Health Operations, Inc. ("SIHO") v. George*,<sup>154</sup> the court discussed what happens when an administrator of an ERISA-controlled plan seeks to subrogate for medical expenses paid on behalf of the injured participant from the participant's settlement with his insurance carrier.

In *SIHO*, the plan participant settled with his insurance carrier for \$145,000 under the uninsured motorist coverage provision.<sup>155</sup> Upon learning of the settlement, the ERISA Plan Administrator asserted a subrogation lien against a portion of the medical expenses paid by the plan.<sup>156</sup> The Plan Administrator relied upon language in the plan requiring reimbursement for any recovery by the participant of amounts paid from a "third party."<sup>157</sup>

The trial court granted summary judgment against the Plan Administrator in his attempt to enforce the subrogation provision.<sup>158</sup> The appellate court discussed whether the Plan Administrator's decision that recovery of amounts paid by the insured's uninsured motorist carrier satisfied the "third party" proceeds requirement was arbitrary and capricious.<sup>159</sup> Based upon the plan language, the court concluded that the Plan Administrator's decision was not arbitrary and

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150. *Id.* at 296.

151. *Id.*

152. *Id.* at 298.

153. 29 U.S.C. §§1001-461 (1994 & Supp. II 1996).

154. 696 N.E.2d 476 (Ind. Ct. App. 1998).

155. *See id.* at 477.

156. The total amount of medical expenses was \$70,820, but the administrator sought \$46,426 after deducting its share of attorney fees and expenses. *See id.* at 477-78.

157. *See id.* at 478.

158. *See id.*

159. *Id.* at 479-80.



capricious and reversed the summary judgment.<sup>160</sup>

A Plan Administrator is granted a great deal of discretion in administering an ERISA plan. This case exemplifies that discretion when interpreting the subrogation rights of the plan to recover amounts paid.

*B. Material Misrepresentation on Medical Insurance Policy*

The decision of *Ruhlig v. American Community Mutual Insurance Co.*,<sup>161</sup> contains an excellent analysis of what to do when an insured makes material misrepresentations on a medical policy application. The insured submitted an application and, when asked to identify any visits with medical practitioners over a ten year period, only listed the medical treatment she received for pneumonia.<sup>162</sup> The applicant also authorized release of her medical records to the insurer. Based on the applicant's statements, the insurance company issued a policy to the applicant. Approximately one year after the policy was issued, the insured underwent coronary surgery and incurred costly medical expenses.<sup>163</sup> The insurer investigated and learned that the insured had been diagnosed, within ten years prior to her application, with chronic obstructive pulmonary disease ("COPD"), pulmonary fibrosis, and lumbar disc disease.<sup>164</sup>

Based on these omissions in the application, the insurer rescinded the insured's policy, refunded her premium, and refused to pay her medical expenses.<sup>165</sup> The insured filed a breach of contract action against the insurer and the insurer responded by filing a Counterclaim for Declaratory Judgment seeking policy rescission.<sup>166</sup> The insurer then filed a Motion for Summary Judgment accompanied by an affidavit from the insurer's underwriter stating that if the insurer had known of the insured's medical problems, a policy would not have been issued.<sup>167</sup>

The trial court granted the insurer's request for summary judgment and the insured appealed.<sup>168</sup> The appellate court discussed when an insurance company may successfully seek rescission based upon omissions in the application:

False representations on an insurance application made by an insured concerning a material fact, which mislead, will void an insurance contract, just as in any other contractual relationship, regardless of whether the misrepresentation was innocently made or made with fraudulent intent. . . . A representation is material if the fact omitted or misstated, if truly stated, might reasonably have influenced the insurer

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160. *Id.* at 480.

161. 696 N.E.2d 877 (Ind. Ct. App. 1998).

162. *See id.* at 878.

163. *See id.*

164. *See id.* at 878-79.

165. *See id.* at 879.

166. *See id.*

167. *See id.*

168. *See id.*

in deciding whether to reject or accept the risk or charge a higher premium.<sup>169</sup>

Based upon the evidence presented by the insurance company, the court of appeals affirmed the summary judgment permitting rescission.<sup>170</sup> The court also rejected the insured's argument that the insurer is precluded from seeking rescission based upon its failure to discover the insured's medical condition when the name, address and phone number of her doctor is included on the application.<sup>171</sup> The court acknowledged that the insured could reasonably rely on the truthfulness of the insured's application and has no duty to search for inconsistencies in the application.<sup>172</sup>

This decision clearly allows the insurers to rely upon the statements of the insureds in acquiring coverage. It would be unreasonable to require the insurers to verify all information on all applications before issuing coverage. Instead, the doctrine of rescission still remains a viable procedure to address material misrepresentations on policy applications.

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169. *Id.* at 880 (citations omitted).

170. *Id.* at 881-82.

171. *Id.* at 881.

172. *Id.*