UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

KATHLEEN RUGGIERO, **Plaintiff,**	**:**	**CIVIL ACTION NO.** **3:11-cv-00760 (AWT)**
VS.	**:**	
HARLEYSVILLE PREFERRED **INSURANCE COMPANY,** **Defendant.**	**:**	**JULY 10, 2014**

BRIEF RE DAMAGES FOR BREACH OF AN INSURANCE CONTRACT

TABLE OF CONTENTS

How can we cheat thee? Let me count the ways.

Preface

The Insurance Contract

Uberrima fides

I. DEVELOPMENT OF COMMON LAW DOCTRINE OF GOOD FAITH & FAIR DEALING

A. Roots of Concept of Good Faith and Fair Dealing

B. Immediate California precedents

C. Gruenberg

D. Developments since Gruenberg

E. Connecticut case development

II. NEGLIGENCE

III. EXTRA-CONTRACTUAL DAMAGES

IV. CONCLUSION

How can we cheat thee? Let me count the ways.

The conduct of Harleysville, from the moment the claim was filed by Ruggiero, throughout the investigation of the claim, as well as the litigation, including trial preparation can be summed up with the phrase: **How can we cheat thee? Let me count the ways.**

The defendant is now trying to hoodwink the Court with the notion that this is a simple breach of contract case. It is not. This is an ***insurance*** contract, and different principles apply. The defendant is preposterously trying to avoid the obvious - the "implied covenant of good faith and fair dealing" which automatically exists by operation of law in every insurance contract.

Preface

Nearly twenty years ago, Tom Baker wrote a law review article, ***Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages***,[1] describing this culture and differing views of the insurance customer:

> Insurance companies tell two different sets of stories about insurance and two distinct points in the insurance relationship. When marketing their services, insurance companies tell what I will call “sales stories.” This first set of stories, drawn from insurance advertising, responds to the fears of dependency that are epitomized by *King Lear*. When handling claims, insurance companies tell a second set of stories, which I will call “claims stories.” This second set of stories, drawn from fieldwork with adjusters and from insurance adjustment trade literature, stresses the need to protect the insurance fund from overreaching, as dramatized (perhaps overdramatized) by *King Richard III*. These two sets of stories evoke quite different visions of the insurance relationship. The continuing trouble of the courts in defining the obligations of the insurance relationship stems in part from this duality, which is also apparent in judicial opinions.9 In the abstract at least, both visions are equally “right” (and just as equally “wrong”). Yet, the choice of lens can determine whether the insured in a particular case is seen as poor King Lear or wicked King Richard.

The Insurance Contract

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[1] Tom Baker, *Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages*, 72 Tex. L. Rev.1395, 1397-98 (1994).

Early insurance contracts were considered to be contracts like any other, but first English (see *uberrima fides*) and then American courts recognized that insurers occupy a special role in society by virtue of their express or implied promise of peace of mind, as well as the severe vulnerability of insureds at the time they actually make claims (usually after a terrible loss or disaster).

Uberrima fides

Uberrima fides is a Latin phrase meaning "utmost good faith" (literally, "most abundant faith"). It is the name of a legal doctrine which governs insurance contracts. This means that all parties to an insurance contract must deal in good faith, making a full declaration of all material facts in the insurance proposal. This contrasts with the legal doctrine *caveat emptor* (let the buyer beware). Thus the insured must reveal the exact nature and potential of the risks that he transfers to the insurer, while at the same time the insurer must make sure that the potential contract fits the needs of, and benefits, the insured.

A higher duty is expected from parties to an insurance contract than from parties to most other contracts in order to ensure the disclosure of all material facts so that the contract may accurately reflect the actual risk being undertaken. The principles underlying this rule were stated by Lord Mansfield in the leading and often quoted case of Carter v Boehm, 97 ER 1162, 1164 (1766).

The doctrine of *uberrima fides* is strictly limited in English law to the *formation* of the insurance contract. During the mid-20th century, American courts expanded it much farther into a post-formation implied covenant of good faith and fair dealing. Violation of that implied covenant came to be seen as a tort, now known as insurance bad faith.

I. DEVELOPMENT OF COMMON LAW DOCTRINE OF GOOD FAITH & FAIR DEALING

Insurance bad faith is a legal term of art unique to the law of the United States (but with parallels elsewhere, particularly Canada) that describes a tort claim that an insured person may have against an insurance company for its bad acts. Under the law of most jurisdictions in the United States, insurance companies owe a duty of good faith and fair dealing to the persons they insure. This duty is often referred to as the "implied covenant of good faith and fair dealing" which automatically exists by operation of law in every insurance contract. If an insurance company violates that covenant, the insured person (or "policyholder") may sue the company on a tort claim in addition to a standard breach of contract claim. The contract-tort distinction is significant because as a matter of public policy, punitive or exemplary damages are unavailable for contract claims, but are available for tort claims. In addition, consequential damages for breach of contract are traditionally subject to certain constraints not applicable to tort actions *(see* Hadley v. Baxendale). The result is that a plaintiff in an insurance bad faith case may be able to recover an amount *larger* than the original face value of the policy, if the insurance company's conduct was particularly egregious.

A. Roots of Concept of Good Faith and Fair Dealing

The rule of good faith and fair dealing is an old concept, with roots in Roman law and development under the morality of ecclesiastical, or canon, law.[2] That it should enter into and form a part of every insurance contract was noted as far back as 1766. In Carter v. Boehm,[3] Lord Mansfield stated that good faith was required by both parties to an insurance contract.

Early Connecticut courts took a particularly rigid view of good faith: "In view of

[2] Robert Jerry, *The Wrong Side of the Mountain: a Comment on Bad Faith's Unnatural History,* 72 Tex. L. Rev.1317, 1319 (1994).
[3] 3 Burr. 1905, 97 E.R. 1162.

morality, every representation or action, deviating in the least from the most exact and scrupulous sincerity and truth, is contrary to good faith."[4] The good faith requirement that a party may not conceal what he privately knows to "draw another into a bargain from his ignorance of that fact and his believing the contrary" was emphasized by The Connecticut Supreme Court in 1874.[5] In an 1882 case, the Kentucky Court of Appeals held that, despite contract language to the contrary, a life insurance contract should not be invalidated because of immaterial misstatements.[6]

Summary

As of the early 1950s, the state of the law was that not all contractual obligations are express. Some terms are included as a matter of law. Among these is the covenant of good faith and fair dealing, which is implied by law into every contract. Some courts infer an agency relationship between insurer and insured, especially when the insurer has the contractual right to control of investigation, settlement and defense in a third party claim. Good faith is considered by the duty of reasonable care (breach of which is the tort of negligence), and/or the duty to put the interests of the insured on a par with its own (that is, to act as a reasonably prudent person would act in the investigation/settlement/defense of his own case in his own business. The distinction between these two tests is unclear.[7]

Protecting the insured from excess judgments and not gambling with the insured's money are themes running through the cases. With first party cases the insurance company is held responsible to pay its insured according to a good faith interpretation of the contract. In third party cases, most of which involve unreasonable failure to settle within policy limits, the insurer

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[4] Broome v. Beers, 6 Conn. 198 (1826).
[5] Bollman v. Loomis , 51 Conn 581 (1874) quoting Mansfield's case of more than a century earlier.
[6] Germania Insurance Company of New York v. Rudwig, 80 Ky. 223 (1882).
[7] 44 Am Jur2d 1399-1400.

is held liable for extra contractual damages insofar as they consist of judgments beyond policy limits. Neither the insured tortfeasor nor the victim can require the insurance company to negotiate or to settle. Another standard of behavior is requiring the insurer defend the case as if there were no limits – as if the insurer and the insurer alone would be liable for all damages.[8]

B. Immediate California precedents

The development of the modern cause of action for insurance bad faith can be traced to a landmark[9] decision of the Supreme Court of California: Comunale v. Traders & General Ins. Co., 50 Cal. 2d 654, 328 P.2d 198, 68 A.L.R.2d 883 (1958). Comunale was in the context of third-party liability insurance, but California later expanded the same rule to first-party fire insurance in Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 108 Cal. Rptr. 480, 510 P.2d 1032 (1973).

During the 1970s, insurers argued that these early cases should be read as holding that it was bad faith to deny a claim only when the insurer already *knew* that it had no reasonable basis for denying the claim (i.e., when the insurer had already acquired information showing a potentially covered claim and denied it anyway). In other words, they contended that only *intentional* mistreatment of an insured should be actionable in bad faith, versus merely grossly *negligent* claim handling. In 1979, California's highest court refuted that argument and further expanded the scope of the tort by holding that inadequate *investigation* of a claim was actionable in tort as a breach of the implied covenant of good faith and fair dealing.

C. Gruenberg

[8] Robert Keeton, *Liability Insurance and Responsibility for Settlement*, 67 Harv. L. Rev. 1136, 1183-84 (1954)

[9] Eugene R. Anderson, Jordan S. Stanzler, & Lorelie S. Masters, *Insurance Coverage Litigation* (New York: Aspen Publishers, 2009 supp.), § 11.04 at 11-13 to 11-16.

If outrageous conduct were required, then certainly the instigation by an insurer of arson charges against its insured in order to avoid payment –and then basing its refusal to pay on his refusal to be deposed during the brief pendency of the criminal charges - would certainly qualify.[10]

Gruenberg is the grandmother of all bad faith insurance claims, but like many cases in the development of the common law, it is a modest structure built on all that has come before. In this case, much of what is "new" in Gruenberg is because of the California Supreme Court's affirmation of Fletcher.

Criminal charges were dismissed at a preliminary hearing less than two months after the fire. Less than two weeks later, attorneys for Gruenberg notified the insurance company that he was now prepared to submit himself for an examination under oath, but the insurers reaffirmed their denial because of his earlier failure to appear. Gruenberg claimed severe economic damages, severe emotional distress and sought both compensatory and punitive damages. His complaint was dismissed by the trial court and reinstated by the Supreme Court.

The Court first reviewed the previous holdings. "(I)n Communale (1958) and Crisci (1967) we made it clear the liability is imposed on the insurer not for a bad faith breach of contract but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing."[11]

"These cases involved the duty to act in good faith in handling third party claims as a duty to accept reasonable settlements. Gruenberg concerns the duty of an insurer to act fairly and in good faith in discharging its contractual responsibilities. If it refuses, without proper

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[10] Gruenberg v. Aetna, 9 Cal. 3d 566 (1973).
[11] Id. at 573

cause, to compensate its insured for a loss covered by the policy, such refusal can give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing. The unconscionable conduct of the insurer in Richardson (UIM) and Fletcher (disability insurance) were other manifestations of the same conduct. The cause of action is tort, even though it may also constitute a breach of contract.

The common thread in the cases cited, as well as in Gruenberg itself, is that "in every insurance contract there is an implied covenant of good faith and fair dealing . . . *whether the company is attending to the claims of third persons against the insured or the claims of the insured itself*. Accordingly, when the insurer unreasonably and in bad faith withholds payment of the claim of its insured, it is subject to liability in tort."[12]

The court further explained that the duty to abstain from injuring the person or property of another or infringing on any of his rights is independent of the contract, and attaches above and beyond the terms of that contract. "The insurer's duty is unconditional, and independent of the performance of plaintiff's contractual obligations."[13]

The Gruenberg court upheld recovery for mental suffering (citing Crisci at length) and made it explicit that the extreme and outrageous conduct required as a traditional element of IIED did not apply to these cases. "(I)n the instant case we are concerned with mental distress resulting from a substantial invasion of property interests of the insured and not with the independent tort of intentional infliction of emotional distress…"[14] Gruenberg alleged substantial economic loss as well as mental distress and this was deemed sufficiently pleaded.

Summary

[12] Id. at 575 (emphasis added).
[13] Id. at 578.
[14] Id. at 489.

After Gruenberg, the duty of good faith and fair dealing includes not only the duty to protect its insured from excess judgments by accepting reasonable settlements on third party claims, but on first party claims of the insured himself. Breach of this duty will expose the insurer to all proximately caused harms including excess judgments, emotional distress (defined less stringently than classic IIED), and even, in the appropriate case, punitive damages.)[15]

While the court declined to address liability for isolated emotional distress, it specifically allowed recovery when the emotional distress accompanied either personal injury (the classic tort requirement) or invasion of property interests. It also recognized that when one is buying insurance, one is buying peace of mind and is entitled to damages when and insurer tortiously interferes with that peace of mind. The test of good faith was defined in two closely related ways: the prudent person test (whether a prudent insurer without policy limits would have accepted the settlement offer), and the reasonable person test. The conduct of the insurer need not be outrageous (as in Gruenberg); it need only be unreasonable (as in Crisci). The mental damage to the insured need not be extreme, only a "highly unpleasant mental reaction" (Fletcher).

D. Developments since Gruenberg

Other state courts began to follow California's lead and held that a tort claim exists for policyholders that can establish bad faith on the part of insurance carriers. According to Stephen S. Ashley's treatise, *Bad Faith Actions: Liability and Damages*, 2nd ed. (Eagan, MN: Thomson West, 1997), §§ 2.08 and 2.15, courts in nearly thirty states recognized the claim by the late

[15] *See also* Gilardi, *Good Faith and Fair Dealing in Insurance Contracts: Gruenberg v. Aetna* 25 Hastings LJ 699 (1973).

1990s. In nineteen states, state legislatures became involved and passed legislation that specifically authorized bad faith claims against insurers.

E. Connecticut case development

Connecticut was not far behind California in protecting its consumers. The first Connecticut case to apply the requirement of good faith and fair dealing to first party claims was Grand Sheet Metal Products,[16] a brief opinion involving fire insurance. Hoyt in 1935[17] and Bartlett in 1933[18] had already established that duty for third party cases in the context of failure to settle within policy limits.

The Court asked the rhetorical question "… is it not also the duty of the trial court to forge new paths if based on convincing legal theory?"[19] Public policy considerations included the unequal bargaining power of the parties, the special nature of insurance, and the "disastrous economic effects that a bad-faith refusal to pay may cause the insured…"[20] The Court was not subtle: "The plaintiff is asserting a tortious breach of contract based on a tort claim separate from any claim for breach of contract. In so doing, the plaintiff is attempting to import into Connecticut law the theory, if not the exact language, of the landmark California case of Gruenberg."[21] The Superior Court approved this attempt.

In 1984, the District Court of Connecticut noted in a case involving the refusal of an insurer to pay its insured for the theft of goods under a commercial policy that the majority of Superior Court decisions followed Grand Sheet.[22] Holding that there was "nothing to suggest"

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[16] Grand Sheet Metal Products v. Protection Mutual Insurance Co., 34 Conn. Supp. 46 (1977).
[17] Hoyt v. Factory Mutual Liability, 120 Conn 156 (1935).
[18] Bartlett v. Travelers, 117 Conn 147. 167 A 180 (1933).
[19] Grand Sheet Metal Products v. Protection Mutual Insurance Co., 34 Conn. Supp. 46, 49 (1977).
[20] Id.
[21] Id. at 47.
[22] Doyle v. St. Paul Fire & Marine, 583 F. supp. 554 (D. Conn. 1984).

the Connecticut Supreme Court would not support the "well-reasoned opinions of the Superior Court cases on the question"[23] the defendant's motion to dismiss the count of breach of the duty of good faith and fair dealing was denied.

It was not until 1987 that the Connecticut Supreme Court weighed in on the duty of good faith and fair dealing in insurance contracts.[24] The important holding is that an insurer (even a self-insurer) has the "duty and obligation under the law to deal fairly and in good faith with its insured."[25] Gruenberg is not cited. Several other Connecticut cases including Magnan,[26] are cited for the proposition that "this court recognizes an independent cause of action in tort arising from an insurer's common law duty of good faith. This cause of action is separate and distinct from the plaintiff's statutory claims."[27] An "implied covenant of good faith and fair dealing has been applied by this court in a variety of contractual relationships, including ... insurance contracts."[28] The Supreme Court adopted the plaintiff's request to charge, as had the trial court. Because it so often cited in later cases, the paragraph is cited at length.

> (T)he defendant, "as a self-insurer, had the duty and obligation under the law to deal fairly and in good faith with its insured...." The court instructed the jury that "[g]ood faith and fair dealing means an attitude or state of mind denoting honesty of purpose, freedom from intention to defraud and generally speaking means faithful to one's duty or obligation ... an honest intention not to take an unconscientious [sic] advantage of another...." The court also instructed the jury that "[b]ad faith is defined as the opposite of good faith, generally implying a design to mislead or to deceive another, or a neglect or refusal to fulfill some duty or some contractual obligation not prompted by an honest mistake as to one's rights or duties...." The court further instructed the jury that "bad faith is not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of dishonest purpose or moral obliquity ... it contemplates a state of mind affirmatively operating with furtive design or ill will."

[23] Doyle v. St. Paul Fire & Marine, 583 F. supp. 554, 567 (D. Conn. 1984).
[24] Buckman v. People Express, 205 Conn 166 (1987).
[25] Buckman v. People Express, 205 Conn 166, 171 (1987).
[26] Magnan v. Anaconda, 193 Conn. 558, 566 (1984).
[27] Buckman v. People Express, 205 Conn 166, 170 (1987).
[28] Id.

Buckman v. People Express, 205 Conn 166, 171 (1987).

At first blush, the definition requires a threshold showing of evil behavior, but careful reading shows that "neglect or refusal to fulfill some duty or obligation not prompted by an honest mistake" may suffice. More simply stated, "bad faith means more than mere negligence; it involves dishonest purpose."[29]

In a 1984 case cited earlier, The Supreme Court of Connecticut explained good faith as a "rule of construction designed to fulfill the reasonable expectations[30] of the contracting parties as they presumably intended. The principle, therefore, cannot be applied to achieve a result contrary to the clearly expressed terms of a contact, unless, perhaps, those terms are contrary to public policy."[31]

In Buckman, the plaintiff suffered financial loss and emotional distress as a result of his self-insured employer's bad faith refusal to deal with his request, as authorized by statute, to continue his health insurance. With no discussion f other underlying principles of law, the court accepted the cause of action for emotional distress.[32]

It is undisputed that the covenant of good faith and fair dealing is implied by law into all contracts. More recent cases have listed the specific elements that must be pleaded.

> "(A)n action for breach of the covenant of good faith and fair dealing requires proof of three essential elements, which the plaintiff must duly plead:

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[29] Habetz v. Condon, 224 Conn. 231, 237 (1992).

[30] It may be possible to use the insurer's own advertising copy to suggest what a consumer may reasonably expect. *see* Tom Baker, *Constructing the Insurance Relationship: Sales Stories, Claims Stories, and Insurance Contract Damages,* 72 Tex L. Rev. 1395. Baker cites from a tongue in cheek opinion: "[T]his case can be summed up as follows: Plaintiff, at the inducement of Prudential, got herself a 'piece of the rock,' and now that it's time for the insurance company to pay, Prudential wants to take its rocks and go home.") FN 7. Citations omitted.

[31] Magnan v. Anaconda, *supra*, cited approvingly in McCauley Enterprises v. New Hampshire Insurance Co., 716 F. Supp. 718 (D. Conn., 1989).

[32] Buckman v. People Express, 205 Conn 166, 174 (1987).

first, that the plaintiff and the defendant were parties to a contract under which the plaintiff reasonably expected to receive certain benefits;

second, that the defendant engaged in conduct that injured the plaintiff's right to receive some or all of those benefits; and

third, that when committing the acts by which it injured e plaintiff's right to receive benefits it reasonably expected to receive under the contract, the defendant was acting in bad faith.[33]

The Connecticut Supreme has recently affirmed that Connecticut requires an improper motive or dishonest purpose, it need not rise to the level of fraudulent conduct, and unreasonable conduct can be evidence of improper motive.[34]

II. NEGLIGENCE

A claim sounding in straight negligence (for failing to properly investigate and failing to properly defend) can be asserted when a contractual duty has been violated. The negligence in this context is no different than in any other setting, the violation of a duty caused damages, and not all damages are cognizable in a contract theory. However, even in contract theory there is growing support for the award of consequential damages foreseeable at the time of contracting. Foreseeable damages at the time of contracting can include emotional distress under the right set of facts.

III. EXTRA-CONTRACTUAL DAMAGES

Extra-contractual damages, for breach of an insurance contract, include all foreseeable damages, including emotional distress, punitive damages and attorney's fees. This has been discussed extensively in the preceding sections of this Brief. It is recognized that when one is

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[33] Shareamerica, Inc. v.Ernst & Young. 1999 WL 545417 (Conn.Super.) Judge Sheldon's formulation has been cited by over a dozen Superior Court cases, but has not been reviewed by an appellate court.
[34] PSE Consulting v. Frank Mercede & Sons, 267 Conn. 279 (2004).

buying insurance, one is buying peace of mind and is entitled to damages when and insurer tortiously interferes with that peace of mind.

IV. CONCLUSION

There are a variety of theories upon which the plaintiff can recover damages for breach of an insurance contact, when the plaintiff has produced evidence of egregious bad faith. All such damages can be awarded under the breach of contract claim. Although the plaintiff can also include a claim for breach of negligence, it is not essential when proof of egregious bad faith has been found by the fact finder, as tort damages are a foreseeable for breach of an insurance contract.

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/S/
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