IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MP III HOLDINGS, INC., d/b/a MTA SCHOOLS, PETER C. MORSE and R. BRUCE DALGLISH	:	**CIVIL ACTION**
v.	:	
THE HARTFORD	:	
HARTFORD INSURANCE COMPANY	:	
HARTFORD CASUALTY INSURANCE COMPANY	:	**NO. 05-1569**

NORMA L. SHAPIRO, S.J. **SEPTEMBER 14, 2006**

MEMORANDUM AND ORDER

This is an insurance coverage action. Plaintiff, MP III Holdings, Inc., doing business as MTA Schools ("MP III"), is a bankrupt Delaware corporation that formerly operated truck driving schools. Plaintiffs, Peter C. Morse ("Morse") and R. Bruce Dalglish ("Dalglish"), are citizens of Pennsylvania and former officers and directors of MP III. Plaintiffs' insurer, defendant, Hartford Casualty Insurance Company ("Hartford"),[1] is a Connecticut corporation headquartered in Connecticut. There is federal diversity jurisdiction under 28 U.S.C. § 1332. See June 1, 2005 Mem. & Order (denying plaintiffs' motion to remand).

Plaintiffs' complaint alleges defendant has breached their insurance policy contract and acted in bad faith by refusing to defend plaintiffs in litigation in Pennsylvania, Texas and Delaware. Count I (breach of contract) and Count II (bad faith) arise from the Pennsylvania action; Count III (breach of contract) and Count IV (bad faith) arise from the Texas action; and Count V (breach of contract) and Count VI (bad faith) arise from the Delaware action.

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[1] Defendants "The Hartford" and "Hartford Insurance Company," are fictitious entities. See Notice of Removal at 1. The only properly named defendant is Hartford Casualty Insurance Company; the caption will be amended accordingly.

Defendant has moved to dismiss Counts III through VI (but not Counts I and II) because the complaints in the Texas and Delaware actions allege solely fraudulent conduct and policy exclusions apply. Plaintiffs oppose the motion and cross-move for summary judgment on Count III. Plaintiffs argue the policy exclusions do not apply as the complaints in the Texas and Delaware actions allege both negligent and fraudulent conduct. The court held oral argument on the motions.

The court will grant plaintiffs' cross-motion for summary judgment on Count III because the complaint in the Texas action alleges both negligent and fraudulent conduct. The court will deny defendant's motion to dismiss Counts IV, V and VI.

I. Background

MP III formerly owned and operated truck-driving schools throughout the United States. MP III sold its students' loans to Student Finance Corporation ("SFC"). SFC also bought student loans from Franklin Career Services, Inc. ("Franklin"), a competitor of MP III. SFC securitized these student loans and Royal Indemnity Company ("Royal") insured payment to the security holders in the event of default by the student borrowers. MP III also entered into a loan agreement with Pennsylvania Business Bank ("PBB") by which MP III granted PBB a blanket lien on all of MP III's assets, including its accounts receivable.

In March 2002, SFC collapsed because of a high number of loan defaults by students of MP III and other truck-driving schools. Around this time, Morse and Dalglish sold all of their MP III stock to Franklin, which immediately took control of MP III's operations. Franklin guaranteed PBB that it would repay the outstanding loans PBB had made to MP III, but Franklin failed to do so. PBB repossessed MP III's assets and MP III ceased operations. Complex

litigation involving numerous parties ensued in Pennsylvania, Texas and Delaware as a result of the collapse of SFC and MP III. Hartford agreed to pay plaintiffs' defense costs, in part, for the Pennsylvania action, but refused entirely for the Texas and Delaware actions.

A. The Insurance Policy

MP III purchased a Hartford insurance policy covering the period from February 19, 2001 to February 19, 2002; coverage was extended to July 14, 2002. See Ex. A (Hartford policy) to Compl.. The policy, drafted by Hartford, provided coverage for, *inter alia*, commercial general liability, personal and advertising injury, and educators legal liability ("ELL"). Id. Only the ELL coverage is at issue in this action. See 9/21/05 Hr'g Tr. at 12.

Coverage. The ELL form provides that "[Hartford] will pay, on behalf of the insured, all sums which the insured shall become legally obligated to pay as 'loss' because of any 'wrongful act' to which this insurance applies." Ex. A to Compl. at Form HC 00 67 07 00 at 1. Hartford has "the right and the duty to defend the insured against any 'claim': (1) Alleging injury arising out of a 'wrongful act' to which this insurance applies; and (2) Seeking 'loss' because of such injury." Id. Hartford "will pay 'defense expense,' with respect to any 'claim' . . . arising out of any 'wrongful act.'" Id. The "insurance applies to a 'wrongful act' which occurs anywhere in the world," provided the "'claim' is brought within the United States . . . or Canada" and the "'wrongful act' occurs between, and including, the Retroactive Date and the end of the 'policy period.'" Id. The "insured" includes "You, the 'educational entity'" and "Your Board and its members, trustees and directors." Id. at 4.

Definitions. The ELL form defines "wrongful act" to mean:

(a) "Directors and executive officers wrongful act," in turn defined as "any breach of

duty, neglect, error, misstatement, misleading statement, or omission by one or more 'directors' or 'executive officers' so alleged by any claimant solely by reason of their being a 'director' or 'executive officer' of the 'educational entity;'"

(b) "Educational wrongful act," in turn defined as "any actual or alleged act, error, or omission, including any:

(a) Neglect or breach of duty; or

(b) Misstatement or misleading statement

of any insured while acting within the scope of his or her duties for the 'educational entity' or as authorized by you;"

(c) "Employment benefits wrongful act;" or

(d) "Employment practices wrongful act."

Id. at 10-11. "'Loss' means a compensatory monetary award, remedial award, settlement or judgment, including damages for which you may be required by law to indemnify an insured. 'Loss' does not include fines, penalties or obligations to pay a sum for which insurance is prohibited by law applicable to the construction of this policy." Id. at 11. "Claim" means a "demand received by any insured for 'loss' alleging an 'employment benefits wrongful act' or an 'educational wrongful act,' by any insured," and "includes any civil proceeding in which either 'loss' is alleged or fact finding will take place, when either is the actual or alleged result of any 'wrongful act' to which this insurance applies." Id. at 9.

Exclusions. The ELL form contains several exclusions, including:

a. Expected or Intended Act

Any "loss" or injury expected or intended from the standpoint of the insured.

b. Dishonest, Fraudulent, Criminal or Malicious Act

Any "claim" arising out of any dishonest, fraudulent, criminal or malicious act or

omission of the insured. . . . This exclusion applies only to insureds:

(1) Who committed such act or omission;

(2) Who participated in planning, committing or ratifying such act or omission; or

(3) Who had knowledge of such act or omission and failed to take corrective action.

* * *

f. Illegal Financial Gain

Any "claim" arising out of any insured obtaining or attempting to obtain remuneration or financial gain to which such insured was not legally entitled. This exclusion applies only to the insured(s) who obtains or attempts to obtain the remuneration or financial gain.

* * *

I. Contractual Liability

Any "claim" arising out of the terms of any contractual obligation.

This exclusion does not apply:

(1) to breach of contract, whether oral, written, express or implied, creating or continuing an employer-employee relationship among the parties to the contract; or

(2) to our right and duty to defend any "claim" resulting from the failure to perform or the breach of any contract. . . .

Id. at 2.

B. The Pennsylvania Action

In Pennsylvania Business Bank v. MP III Holdings, Inc., et al., May Term 2002, No. 2507 (Phila. Ct. Com. Pl.), PBB has sued Franklin, MP III, Morse, Dalglish and others in connection with Franklin's agreement to purchase MP III, which PBB claims was intended to defraud PBB.

See Ex. C (Fourth Am. Compl.[2] in PA Action) to Compl.. PBB seeks declaratory judgments against MP III, Morse and Dalglish and damages for alleged "negligent misrepresentation." See id. Count 1, Count 2 and Count 7). Morse and Dalglish intervened as plaintiffs in the Pennsylvania action, and PBB filed counterclaims against them for tortious interference, fraud and unjust enrichment. See Ex. D (PBB's Countercl.) to Compl.. Franklin filed cross-claims against MP III for fraudulent misrepresentation, negligent misrepresentation, "breach of express duty to negotiate in good faith," and "breach of duty of good faith and fair dealing/implied covenant of good faith." See Ex. E (Franklin's Cross-cl.) to Compl..

At Reed Smith LLP's customary rates, ranging from $310/hour for associate time to $600/hour for partner time, MP III, Morse and Dalglish have incurred over $1.2 million in attorney's fees defending the initial claims, counterclaims and cross-claims in the Pennsylvania action. MP III, Morse and Dalglish have entered into a coverage agreement with Hartford – with both sides reserving their rights – in which Hartford has agreed to pay attorney's fees at $125/hour for associate time and $200/hour for partner time. At these rates, Hartford has paid over $600,000 to plaintiffs for defense costs relating to PBB's initial claims against plaintiffs. However, Hartford has refused to pay for defense costs relating to PBB's counterclaims and Franklin's cross-claims because, Hartford asserts, those claims sound in intentional tort and fraud and are excluded from the policy, whereas PBB's initial claims sound in negligence and are covered.

[2] The fourth amended complaint is the operative complaint in the Pennsylvania action. See 9/21/05 Hr'g Tr. at 10.

C. The Texas Action

In Royal Indemnity Company v. MP III Holdings, Inc., et al., Cause No. D167370 (Dist. Ct. Jefferson County, 58th Judicial Dist.), Royal has sued MP III and other truck-driving schools for allegedly engaging in fraudulent tuition loan schemes with SFC to mislead Royal and induce it to provide insurance against defaults by the student borrowers. See Ex. A (7th Am. Compl.[3] in TX Action) to Def.'s Opp. to Pls.' Cross-Mot. for Summ. J.. Royal asserts counts for fraud, fraudulent nondisclosure, negligent misrepresentation, civil conspiracy, "aiding and abetting," and "piercing MP III's corporate veil: sham to perpetrate a fraud" against MP III, Morse and Dalglish. Id.

Although Hartford has agreed to pay, in part, for the defense of MP III, Morse and Dalglish in the Pennsylvania action, Hartford has refused to pay for their defense in the Texas action, notwithstanding the similarities between the allegations and counts in the Pennsylvania and Texas complaints. Hartford attempts to justify this distinction by asserting the Pennsylvania claims, sounding in negligence, are covered by the policy, but the Texas claims – despite the count for negligent misrepresentation – sounding in intentional tort and fraud, are excluded by the policy. MP III, Morse and Dalglish argue this is a false distinction and evidence of Hartford's bad faith.

D. The Delaware Action

In Stanziale v. MP III Holdings, Inc., et al., Adversary Proceeding No. 04-56408 (Bankr. D. Del.), SFC's bankruptcy trustee seeks to recover $32 million transferred by SFC to MP III as

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[3] The seventh amended complaint – called a "petition" in Texas state court – is the operative complaint in the Texas action. See 9/21/05 Hr'g Tr. at 8.

part of the allegedly fraudulent tuition loan scheme at issue in the Texas action. See Ex. O (Compl.[4] in DE Action) to Compl.. The trustee asserts counts against MP III for avoidance of fraudulent transfers, recovery of fraudulent transfers, accounting, and contractual indemnity.

Hartford has refused to pay for MP III's defense in the Delaware action. Hartford asserts the Delaware claims, including the count for contractual indemnity, sound in intentional tort and fraud rather than negligence or breach of contract. As with the Texas claims and the Pennsylvania counterclaims and cross-claims, Hartford asserts the Delaware claims are excluded under the policy.

II. Discussion

A. Standard of Review

On a motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) (failure to state a claim upon which relief can be granted), the court must accept as true all well-pleaded allegations of fact in the plaintiff's complaint, and any reasonable inferences that may be drawn therefrom, and must determine whether "under any reasonable reading of the pleadings, the plaintiff may be entitled to relief." Nami v. Fauver, 82 F.3d 63, 65 (3d Cir. 1996); Mark I Restoration SVC v. Assurance Co. of Am., 248 F. Supp.2d 397, 399 (E.D.Pa. 2003). A court need not credit the complaint's "bald assertions" or "legal conclusions." In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1429-30 (3d Cir. 1997) (citations omitted). On a motion to dismiss, the court may consider the allegations in the complaint, exhibits attached to the complaint, and matters of public record. Pension Ben. Guar. Corp. v. White Consol. Indus., Inc., 998 F.2d 1192, 1196 (3d

[4] The court has not been made aware of any amendments to the complaint in the Delaware action.

Cir. 1993); see also 5A C. Wright & A. Miller, Federal Practice and Procedure § 1357, at 299 (2d ed. 1990).

Summary judgment is appropriate where the record shows there that is "no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). Material facts are those which bear upon the outcome of the case. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). All reasonable factual inferences must be made in a light most favorable to the nonmoving party. Id. at 255. However, the nonmoving party bears the burden to establish the existence of each element of his case. Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1991). In doing so, the plaintiff must present specific evidence from which a reasonable fact finder could conclude in his favor. Anderson, 477 U.S. at 248; Jones v. United Parcel Serv., 214 F.3d 402, 407 (3d Cir. 2000). Mere conclusory allegations or denials are not enough to preclude summary judgment. Jones, 214 F.3d at 402; Schoch v. First Fidelity Bancorporation, 912 F.2d 654, 657 (3d Cir. 1990). A plaintiff "may, at any time after the expiration of 20 days from the commencement of the action . . . move with or without supporting affidavits for a summary judgment . . . upon all or any part thereof." Fed. R. Civ. P. 56(a).

B. Relevant Law

The parties agree the insurance policy is governed by Pennsylvania law. 9/21/05 Hr'g Tr. at 3. In Pennsylvania, the interpretation of an insurance contract is usually a function for the court. Melrose Hotel Co. v. St. Paul Fire and Marine Ins. Co., 432 F. Supp.2d 488, 495 (E.D. Pa. 2006); 401 Fourth St., Inc. v. Investors Ins. Group, 879 A.2d 166, 171 (Pa. 2005). In reading the policy, the court must construe words of common usage in their natural, plain and ordinary sense. Jacobs Constructors, Inc. v. NPS Energy Servs., Inc., 264 F.3d 365, 376 (3d Cir. 2001); Madison

Constr. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 108 (Pa. 1999). If the policy defines certain terms, the court must apply those definitions. J.C. Penney Life Ins. Co. v. Pilosi, 393 F.3d 356, 363 (3d Cir. 2004); Monti v. Rockwood Ins. Co., 450 A.2d 24, 25 (Pa. Super. 1982). When the policy language is clear and unambiguous, the court must enforce that language. Med. Protective Co. v. Watkins, 198 F.3d 100, 103 (3d Cir. 1999); Standard Venetian Blind Co. v. Am. Empire Ins. Co., 469 A.2d 563, 566 (Pa. 1983). If the policy language is ambiguous, i.e., susceptible to more than one interpretation, it must be construed against the insurer. Pilosi, 393 F.3d at 363; Watkins, 198 F.3d at 103; Melrose Hotel, 432 F. Supp.2d at 495-96; Madison Constr., 735 A.2d at 106. "Exclusionary clauses for 'expected or intended' damage, as a matter of law, are ambiguous and must be construed against the insurer . . . ." Germantown Ins. Co. v. Martin, 595 A.2d 1172, 1175 (Pa. Super. 1991) (citing United Servs. Auto. Ass'n v. Elitzky, 517 A.2d 982, 987 (Pa. Super. 1986).

An insurer's duty to defend is broader than its duty to indemnify. Sikirica v. Nationwide Ins. Co., 416 F.3d 214, 225 (3d Cir. 2005); Mut. Benefit Ins. Co. v. Haver, 725 A.2d 743, 746 n.1 (Pa. 1999); Erie Ins. Exch. v. Muff, 851 A.2d 919, 925 (Pa. Super. 2004). The duty to defend arises "whenever the complaint filed by the injured party may *potentially* come within the policy's coverage." Pacific Indem. Co. v. Linn, 766 F.2d 754, 760 (3d Cir. 1985); see also Sikirica, 416 F.3d at 225; Erie Ins. Exch. v. Transamerica Ins. Co., 533 A.2d 1363, 1368 (Pa. 1987); Cadwallader v. New Amsterdam Cas. Co., 152 A.2d 484, 488 (Pa. 1959). "[T]he particular cause of action that a complainant pleads is not determinative of whether coverage has been triggered. Instead it is necessary to look at the factual allegations contained in the complaint." Haver, 725 A.2d at 538-39; see also Melrose Hotel, 432 F. Supp.2d at 496; Donegal

Mut. Ins. Co. v. Baumhammers, 893 A.2d 797, 811 (Pa. Super. 2006). The factual allegations are liberally construed in favor of the insured. Frog, Switch & Mfg. Co., Inc. v. Travelers Ins. Co., 193 F.3d 742, 746 (3d Cir. 1999); Biborosch v. Transamerica Ins. Co., 603 A.2d 1050, 1052 (Pa. Super. 1992). If the underlying "complaint avers facts that *might* support recovery under the policy, coverage is triggered and the insurer has a duty to defend." Sikirica, 416 F.3d at 226 (emphasis added); Gen. Accident Ins. Co. of Am. v. Allen, 692 A.2d 1089, 1095 (Pa. 1997). If some of the allegations are covered by the policy, the insurer is obliged to defend the entire action. American Contract Bridge League v. Nationwide Mut. Fire Ins. Co., 752 F.2d 71, 75 (3d Cir.1985); Bracciale v. Nationwide Mut. Fire Ins., No. 92-7190, 1993 WL 323594, at *5 (E.D. Pa. Aug. 20, 1993). The duty to defend exists until the insurer can "'confine the claim to a recovery that the policy [does] not cover.'" Jacobs Constructors, 264 F.3d at 376; see also Minnesota Fire and Cas. Co. v. Greenfield, 855 A.2d 854, 859 (Pa. 2004); Cadwallader,152 A.2d at 488 (Pa. 1959).

An insurer that denies coverage based on a policy exclusion bears the burden of proving that defense. Madison Constr. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 106 (Pa. 1999). When deciding whether an "intended injury" exclusion applies, Pennsylvania courts ask "whether the insured 'desired to cause the consequences of his act or if he acted knowing that such consequences were substantially certain to result.'" Melrose Hotel, 432 F. Supp.2d at 496 (quoting Elitzky, 517 A.2d at 987); see also Wiley v. State Farm Fire & Cas. Co., 995 F.2d 457, 460 (3d Cir. 1993). For the intended injury exclusion to apply, "the insured must have specifically intended to cause harm." Wiley, 995 F.2d at 460; see also Elitzky, 517 A.2d at 987. "The [intended injury] exclusion is inapplicable even if the insured should reasonably have

foreseen the injury which his actions caused." Aetna Life & Cas. Co. v. Barthelemy, 33 F.3d 189, 191 (3d Cir. 1994) (citing Elitzky, 517 A.2d at 987).

C. Count III – the Texas Action

The parties agree there is no dispute of material fact precluding summary judgment on Count III. See 9/21/05 Hr'g Tr. at 37. The relevant documents – the Hartford policy and the Seventh Amended Complaint – speak for themselves. The policy language is clear that MP III, Morse and Dalglish are covered insureds. See Ex. A (Hartford policy) to Compl. at Form HC 00 67 07 00 at 4; 9/21/05 Hr'g Tr. at 23. Setting aside the intended injury exclusions, the policy language clearly covers the factual allegations supporting the counts for fraudulent nondisclosure and negligent misrepresentation in the Texas complaint. The ELL form defines "wrongful act" to include: (1) "any breach of duty, neglect, error, *misstatement, misleading statement, or omission*" (directors and executive officers wrongful act) (emphasis added); or (2) "any actual or alleged act, error, or *omission*, including any [n]eglect or breach of duty or *[m]isstatement or misleading statement*" (educational entity wrongful act) (emphasis added). Ex. A to Compl. at Form HC 00 67 07 00 at 10. Hartford agrees that the MP III corporate entity, doing business as MTA Schools, is only capable of acting through its officers and directors, including Morse and Dalglish. 9/21/05 Hr'g Tr. at 24.

The only issue in Count III is whether any of the allegations in the Texas complaint fall outside the intended injury exclusions for: (1) expected or intended acts; (2) dishonest, fraudulent, criminal or malicious acts; or (3) illegal financial gain. Ex. A to Compl. at Form HC 00 67 07 00 at 2. In the present context, these three exclusions are essentially variations of the same: an insured is not covered for intentionally causing an injury. See State Farm Fire and Cas.

Co. v. Corry, 324 F. Supp.2d 666, 672 (E.D. Pa. 2004) (Pollak, J.) ("[N]egligence claims do not fall within policy exclusions for injuries 'expected or intended' by the insured . . . . [or] for 'willful or malicious acts.'"); see also Melrose Hotel, 432 F. Supp.2d at 507 (providing insurance for acts that intentionally cause harm contravenes Pennsylvania public policy); see also Elitzky, 517 A.2d at 987; Nationwide Mut. Ins. Co. v. Hassinger, 473 A.2d 171, 173 (Pa. Super. 1984). If the Texas complaint alleges facts that support *only* allegations of intentional harm, Hartford has no duty to defend MP III, Morse and Dalglish in the Texas action. However, if the alleged facts may potentially support allegations of *both* intentional and unintentional harm, Hartford has a duty to defend the entire action.

In State Farm v. Corry, Lipschutz, Savage, et al., an insurance company sought a declaratory judgment stating it had no duty to defend its insured in a personal injury action that alleged both intentional and negligent conduct. 324 F. Supp.2d 666. The complaint at issue alleged the following:

> The occurrence and/or accident referred to in [Lipschutz and Savage's] Civil Action Complaint . . . was due to the negligence, carelessness, recklessness and intentional conduct of Additional Defendant William Corry which conduct consisted of the following:
> a) failure to follow instructions of the security guards and other personnel of SALP and Comcast et. al. with regard to behavior and conduct at the Flyers game . . . ;
> b) intentionally assaulted and or struck [Lipschutz and Savage] . . . ;
> c) failure to control his own behavior, resulting in an altercation and/or assault and or battery by William Corry against [Lipschutz and Savage];
> d) failure to act in a reasonable manner within the SALP facility at the Flyers Hockey game;
> e) creating an unsafe situation by which [Lipschutz and Savage] allegedly were injured.

Id. at 672. Despite the fact that the underlying complaint stated claims of intentional tort, including assault, State Farm had a duty to defend because some claims sounded in negligence.

Id. at 672-73.

Similarly, in this action, the factual allegations in the Texas complaint sound in both intentional tort and negligence. Royal asserts, *inter alia*, counts for fraud, fraudulent nondisclosure, and negligent misrepresentation against MP III, Morse and Dalglish. See Ex. A (7th Am. Compl. in TX Action) to Def.'s Opp. to Pls.' Cross-Mot. for Summ. J.. The fraud count, which sounds in intentional tort, alleges in part:

> 31. As is described above, when Delta, MP III, and Coastal submitted loan applications, supporting documents, and initial payments on loans, they made numerous misrepresentations, including that: (a) the loans were properly underwritten, (b) information contained in the applications and loans was true and accurate, (c) the co-signors were real co-signors, willing and able to re-pay the loans if the applicants failed to do so, (d) the initial payments on the loans were made by the borrowers, (e) the loans were performing and seasoned, (f) the personal references included in the applications were real references, and not school employees or agents, (g) the applicants were capable of obtaining and holding employment in their field of training, (h) the applicants were capable of repaying the loans, and (i) the applicants were willing to repay the loans.
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> 33. All of these representations were false. At the very least, these representations were made recklessly without any knowledge of the truth and either as a positive assertion or in the form of promises without a present intention to perform them.
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> * * *
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> 35. Delta, MP III, and Coastal made, directed and authorized the misrepresentations with the intention that they should be acted on by Royal in entering into the insurance policies, or with reason to expect that misinformation would influence the conduct of an insurer sitting in Royal's position.

Id. at 8-9. The negligent misrepresentation count, which sounds in negligence, alleges in part:

> 55. When Delta, MP III, and Coastal submitted loan applications, supporting documents, and initial payments on loans to SFC, they made numerous misrepresentations, including those described in Counts One and Two.
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> 56. All of these representations were false. Delta, MP III, and Coastal failed to

> exercise reasonable care in making the representations, and made them for the guidance of others, including Royal, in their business transactions.
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> 59. Delta, MP III, and Coastal knew that the loans were being securitized, that the loans were being insured as part of the securitizations, and that Royal was providing the insurance. They knew that lenders and insurers were lending money to SFC and insuring the loans based upon a mistaken belief that the loans were real, had been properly underwritten, had been made to applicants who were willing and able to repay them, and were seasoned by several months of borrower payments. At the very least, Delta, MP III, and Coastal failed to exercise reasonable care in supplying false information that insurers in Royal's position would receive, rely upon, and potentially act upon.

Id. at 12-13.

Royal lists various misrepresentations allegedly made by MP III relating to the quality of the student loans which Royal was insuring. Id. ¶ 31. In the fraud count, Royal asserts MP III made these misrepresentations with an intent to harm. Id. ¶ 35. In the negligent misrepresentation count, Royal asserts MP III made these misrepresentations negligently, without exercising reasonable care. Id. ¶ 59. As in Corry, the underlying complaint makes factual allegations sounding in both intentional tort and negligence. 324 F. Supp.2d at 672. The acts MP III is alleged to have committed – submitting student loan documentation containing misrepresentations relating to the quality of the loans – could have been done with or without an intent to harm according to the allegations in the complaint. This is not a case like Allen where the alleged acts – sexual molestation of children – "could not, in any way, be thought of as accidental or merely the result of poor judgment, which is the essential nature of negligent conduct." Gen. Accident Ins. Co. of Am. v. Allen, 708 A.2d 828, 830 (Pa. Super. 1998).

In some cases coverage has been denied because the alleged acts could never have been performed negligently. E.g., Donegal Mut. Ins. Co. v. Baumhammers, 893 A.2d 797, 819-820

(Pa. Super. 2006) (no coverage for insured who intentionally shot several people); Erie. Ins. Exch. v. Fidler, 808 A.2d 587, 590 (Pa. Super. 2002) (student's assault on classmate, where student "threw [his classmate] against a wall and into a desk" was "intentional conduct as a matter of law"); Germantown Ins. Co. v. Martin, 595 A.2d 1172, 1175 (Pa. Super. 1991) (same as Baumhammers); Donegal Mut. Ins. Co. v. Ferrara, 552 A.2d 699, 701 (Pa. Super. 1989) (no coverage where insured allegedly "willfully and maliciously" kicked plaintiff in groin area causing severe injuries). The alleged acts in those cases could only have been performed with an intent to harm; the misrepresentations alleged in the Texas complaint could have been the result of a fraudulent scheme (intentional tort) or the consequence of poor business judgment (negligence).

The negligent misrepresentation count in the Texas complaint does not require a finding of intentional conduct as a predicate for recovery. See Biborosch v. Transamerica Ins. Co., 603 A.2d 1050, 1058 (Pa. Super. 1992) (finding a duty to defend where the court could not "say that there is no possibility that Jewell [plaintiff in underlying action] might recover damages based upon what were essentially negligent acts, errors and omissions . . . .") (Beck, J.). The same or similar facts support both the fraud and negligent misrepresentation counts, but this is not a situation where the plaintiff has "dress[ed] up a complaint" with the "random use of the word 'negligent'" "to avoid the insurance exclusion." Fed. Ins. Co. v. Potamkin, 961 F. Supp. 109, 112 (E.D Pa. 1997) (citation omitted). Because the factual allegations in the Texas complaint sound in both intentional tort and negligence, Hartford has a duty to defend MP III, Morse and Dalgish in the Texas action as long as the negligent misrepresentation count remains. Summary judgment will be granted for MP III, Morse and Dalglish on Count III.

D. Count V – the Delaware Action

Hartford has moved to dismiss Count V. MP III opposes the motion but has not cross-moved for summary judgment on this count.

The Hartford policy covers claims arising from breach of contract but excludes claims arising from intentional injury, fraudulent acts and illegal financial gain. Ex. A to Compl. at Form HC 00 67 07 00 at 10. SFC's bankruptcy trustee asserts counts against MP III for avoidance of fraudulent transfers, recovery of fraudulent transfers, accounting, and contractual indemnity. See Ex. O (Compl. in DE Action) to Compl.. The contractual indemnity count alleges in part:

> 150. The MTA School Defendants agreed to the following requirements in the Student Loan Processing Agreement: (a) that they would confirm the identity of student-applicants; (b) that they would provide accurate student enrollment information on the applications; (c) that they would obtain original borrower and co-signor signatures on loan documents and (d) that they would return to SFC or SMS[5] any loan proceeds for students not enrolled at the school. . . .
>
> 151. The MTA Schools failed to comply with these contractual requirements. The MTA Schools, on information and belief, provided false information on student applications. The MTA Schools, on information and belief, failed to obtain original borrower and co-signor signatures on loan documents; instead, they provided forged applicant and co-signor signatures on many loan documents. The MTA Schools, on information and belief, failed to return to SFC, SLS[6] or SMS loan proceeds for students not enrolled at the schools.
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> 152. In the second type of contract, the "Student Loan Purchase Agreement," the MTA Schools warranted that the loans were: (a) generated in the ordinary course of business and (b) in compliance with state and federal law. Additionally, they agreed to: (a) obtain original signatures of the borrower and co-signor on the loans and (b) return all monies from any loans made to students not enrolled at the school, whose payments on the loans were delinquent or who had any defense to payment on the loan. . . .

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[5] SMS is an affiliate of SFC.

[6] SLS is another affiliate of SFC.

> 153. The MTA Schools failed to comply with these contractual requirements. First, on information and belief, they did not generate the loans in the ordinary course of business; instead, they generated many of the loans from people who could not graduate from the schools and/or could not obtain a truck driving job. Second, on information and belief, the loans were not in compliance with state and federal law and contained many misrepresentations about the identity of the applicants and co-signors, the income of the applicants and the authenticity of the signatures appearing thereon. Third, on information and belief, these MTA Schools did not obtain original signatures of the borrower and co-signor on the loans. They also, on information and belief, did not return proceeds on loans made to students not enrolled at the schools, whose payment were delinquent or who had any defense to payment on the loan.

Id. at 28-29.

With regard to the Student Loan Processing Agreement, the trustee alleges MP III failed to comply with various contractual requirements relating to the administration of its student loans. Id. ¶ 150. Although certain allegations that allegedly gave rise to MP III's breach of contract with SFC undoubtedly describe intentional injury (e.g., "they provided forged applicant and co-signor signatures on many loan documents"), other allegations describe negligent injury (e.g, "[they] provided false information on student applications;" "[they] failed to obtain original borrower and co-signor signatures on loan documents;" "[they] failed to return to SFC, SLS or SMS loan proceeds for students not enrolled at the schools"). Id. ¶ 151. With regard to the Student Loan Purchase Agreement, the trustee alleges further contractual failures by MP III relating to the generation of its student loans and the sale of those loans to SFC. Id. ¶ 152. Certain allegations describe intentional or other excluded injury (e.g., "they did not generate the loans in the ordinary course of business;" "the loans were not in compliance with state and federal law"), while other allegations describe arguably negligent injury ("they generated many of the loans from people who could not graduate from the schools and/or could not obtain a truck driving job;" "the loans . . . contained many misrepresentations about the identity of the

applicants and co-signors [and] the income of the applicants"). Id. ¶ 153.

The factual allegations relating to MP III's alleged breach of contract describe both intentional and negligent injury. According to the complaint, all of the alleged acts that purportedly breached MP III's contracts with SFC could have been done with or without intent to harm. Id. ¶¶ 150 and 152. The trustee did not make allegations of intent in the contractual indemnity count because "[i]ll will or malice is not an element of a cause of action for breach of contract . . . ." Biborosch v. Transamerica Ins. Co., 603 A.2d 1050, 1058 (Pa. Super. 1992) (Beck, J.). As with the actions alleged in the Texas negligent misrepresentation count, the actions alleged in the Delaware contractual indemnity count could have been either the result of a fraudulent scheme or poor business judgment. See supra part C. The trustee need not prove intent to harm in order to recover on the contractual indemnity claim against MP III. See Biborosch, 603 A.2d at 1058. Because the factual allegations in the Delaware complaint allege both intentional and negligent injury, Hartford has a duty to defend MP III under the terms of the insurance policy. MP III has asserted a viable cause of action against Hartford for breach of contract in Count V. Hartford's motion to dismiss Count V will be denied.

E. Counts IV and VI – the Bad Faith Claims

Hartford argues that Counts IV and VI should be dismissed even if the court grants summary judgment for MP III, Morse and Dalglish on Count III and denies Hartford's motion to dismiss Count V. Def.'s Opening Br. at 22. Hartford's argument is without merit.

To assert a viable bad faith claim, a plaintiff must allege two elements: "(1) that the insurer lacked a reasonable basis for denying benefits; and (2) that the insurer knew or recklessly disregarded its lack of reasonable basis. " Klinger v. State Farm Mut. Auto. Ins. Co., 115 F.3d

230, 233 (3d Cir. 1997) (citing Terletsky v. Prudential Property and Cas. Ins. Co., 649 A.2d 680, 688 (Pa. Super. 1994).[7] The instant complaint alleges:

(1) Hartford has refused to pay MP III, Morse and Dalglish's defense costs in the Texas action (Compl. ¶¶ 72 and 76) and Delaware action (id. ¶¶ 86);

(2) Hartford lacked a reasonable basis in law or fact for denying such coverage in the Texas action (id. ¶¶ 73-75, 120) and Delaware action (id. ¶¶ 87-89, 134);

(3) Hartford knew or should have known that, as a matter of law, it had a duty to defend MP III, Morse and Dalglish in the Texas action (id. ¶ 73) and Delaware action (id. ¶87); and

(4) Hartford's actions constitute bad faith in relation to the Texas action (id. ¶ 77-78, 121-123) and Delaware action (id. ¶ 90-91, 135-137).

MP III, Morse and Dalglish have asserted causes of action in Counts IV and VI sufficient to withstand a motion to dismiss under Rule 12(b)(6).[8] Hartford's motion to dismiss the bad faith counts will be denied.

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[7] The Terletsky court defined bad faith as:

> any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith.

649 A.2d at 688.

[8] Hartford asserts its refusal to pay for MP III, Morse and Dalglish's defense costs in the Texas and Delaware actions was "reasonable." Def.'s Opening Br. at 2. Reasonableness in this context is a fact question more appropriately resolved after the close of discovery. The motion to dismiss is without prejudice to a motion for summary judgment.

III. Conclusion

The court will grant plaintiffs' cross-motion for summary judgment on Count III. The court will deny defendant's motion to dismiss Counts III through VI. An appropriate order follows.

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MP III HOLDINGS, INC., d/b/a MTA SCHOOLS, PETER C. MORSE and R. BRUCE DALGLISH	:	**CIVIL ACTION**
v.	:	
THE HARTFORD HARTFORD INSURANCE COMPANY HARTFORD CASUALTY INSURANCE COMPANY	:	**NO. 05-1569**

ORDER

AND NOW, this 14th day of September, 2006, upon consideration of defendant's motion to dismiss Counts III through VI of the complaint, plaintiffs' opposition thereto and cross-motion for summary judgment on Count III, and defendant's opposition thereto, after a hearing and oral argument on September 21, 2005 at which counsel for all parties were heard, for the reasons stated in the foregoing memorandum, it is **ORDERED** that:

1. The caption of this case is amended to read as follows:

MP III HOLDINGS, INC., d/b/a MTA SCHOOLS, PETER C. MORSE and R. BRUCE DALGLISH	:	**CIVIL ACTION**
v.	:	
HARTFORD CASUALTY INSURANCE COMPANY	:	**NO. 05-1569**

2. Defendant's motion to dismiss Counts III through VI (paper # 4) is **DENIED**.

3. Plaintiffs' cross-motion for summary judgment on Count III (paper # 20) is **GRANTED**.

4. Defendant shall file an answer to plaintiffs' complaint as to Counts I, II, IV, V and VI on or before **October 4, 2006**.

5. A status conference is scheduled for **October 23, 2006** at **2:00 p.m.**

S.J.