

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

DAVID EISENBERG, Chapter 7
Trustee for the Estate of
Leonard A. Pelullo

v.

NATIONAL UNION FIRE INS. CO.
OF PITTSBURGH

CIVIL ACTION

NO. 97-5591

Broderick, J.

July 8, 1998

MEMORANDUM

Leonard Pelullo originally brought this civil action against Defendant National Union Fire Insurance Company of Pittsburgh, Pennsylvania ("National Union") in July of 1996 as an adversary proceeding in the United States Bankruptcy Court for the Eastern District of Pennsylvania, where Mr. Pelullo had filed a voluntary petition under Chapter 11 of the United States Bankruptcy Code. In his adversary complaint, Mr. Pelullo alleged bad faith on the part of National Union in connection with an insurance claim. Mr. Pelullo's bankruptcy case was subsequently converted to a Chapter 7 proceeding, and David A. Eisenberg, the Chapter 7 Trustee, is now prosecuting Mr. Pelullo's bad faith claim and is therefore the "Plaintiff" as referred to herein.

In November of 1996, Defendant National Union filed a motion to withdraw the reference to the Bankruptcy Court pursuant to 28

U.S.C. § 157(d), which provides that the district court may withdraw any case referred to the bankruptcy court for "cause shown." Whether there is cause depends, as a threshold matter, on whether a proceeding is "core" or "non-core." This Court determined that the adversary action was "non-core" in that it did not invoke a substantive right provided by title 11, and it was not the sort of proceeding which could only arise in the context of bankruptcy. The Court further determined that proceeding in the district court would reduce forum shopping and confusion, foster the economical use of the debtors' and creditors' resources, and expedite the bankruptcy process. Thus, on August 15, 1997, the Court granted National Union's motion to withdraw the reference from the bankruptcy court pursuant to 28 U.S.C. § 157(d) (see Leonard A. Pelullo v. National Union Fire Insurance Company of Pittsburgh, PA, 1997 WL 535166).

Although the Court determined that Plaintiff's bad faith claim was "non-core," federal jurisdiction exists because the proceeding is related to his bankruptcy case. 28 U.S.C. § 1334(b). Plaintiff's bad faith cause of action against National Union is the property of the estate and could conceivably impact the handling and financial affairs of the estate. Torkelsen v. Maggio (In re the Guild and Gallery Plus, Inc.), 72 F.3d 1171, 1180-82 (3rd Cir. 1996)(discussing Pacor, Inc. v. Higgins, 743 F.2d 984 (3rd Cir. 1984)).

In the instant action, Plaintiff alleges that National Union failed in bad faith to advance Mr. Pelullo defense costs which he needed to defend himself in a federal criminal action in Jacksonville, Florida (the "Jacksonville Action"). In September of 1993, Mr. Pelullo asserted several claims, including his claim for defense costs in the Jacksonville Action, under a \$5 million directors and officers insurance policy (the "Policy"), which National Union had issued to P-I-E Nationwide, Inc. ("P-I-E"). Mr. Pelullo served as a director of P-I-E from August 1990 through December 1990. Mr. Pelullo's claims under the Policy totaled several million dollars. At the time Mr. Pelullo notified National Union of his claims under the Policy, several other persons and entities had also made competing claims under the Policy, also totaling several million dollars. These claims in the aggregate exceeded the Policy limits of \$5 million. While National Union never denied Mr. Pelullo's claim for defense costs in the Jacksonville Action, it did not advance those costs but participated in an effort to achieve a global settlement of the competing claims under the Policy. When that global settlement failed to materialize, National Union filed an Interpleader Action pursuant to 28 U.S.C. § 1335 in the United States District Court for the Northern District of Georgia (the "Interpleader Action"), naming as defendants Mr. Pelullo and 46 other claimants and potential claimants under the Policy.

In the instant action, Plaintiff further alleges that National Union brought the Interpleader Action in bad faith. Plaintiff claims that as a result of National Union's alleged bad faith in failing to advance the defense costs and in bringing the Interpleader Action, Mr. Pelullo could not adequately defend himself in the Jacksonville Action or challenge the Government's seizure of his business records, resulting in the dissemination of those records to other parties who used them to assert more than \$15 million in civil claims against him.

The bad faith claims currently being litigated in this Court were first raised by Mr. Pelullo as a counterclaim in the Interpleader Action, where Mr. Pelullo alleged that National Union had brought the Interpleader Action in bad faith because Mr. Pelullo and the other claimants under the Policy had reached an "agreement in principle" to settle the competing claims against the Policy. However, no such agreement was ever finalized. On June 4, 1996, the U.S. District Court in Georgia granted summary judgment in the Interpleader Action to both National Union and Mr. Pelullo, but the Court failed to reach the merits of Mr. Pelullo's bad faith counterclaim because the claim was not raised on summary judgment. Mr. Pelullo then brought a motion to have his bad faith counterclaim voluntarily dismissed without prejudice so that final judgment could be entered in the Interpleader Action. The Court granted Mr. Pelullo's motion to

dismiss his bad faith counterclaim without prejudice because the motion was unopposed.

The Interpleader Action concluded in the U.S. District Court in Georgia with the entry of the following Amended Judgment on March 31, 1997:

[It is] Ordered and Adjudged that Judgment is entered in favor of defendant, Manuel Ferro and against plaintiff National Union, pursuant to the court's order dated October 29, 1996, in the amount of \$6,937.16, to be paid out of the policy proceeds, with interest at the legal rate of 5.64% per annum, from date of judgment until paid in full, and costs of this action, it is

Further Ordered and Adjudged, pursuant to order of January 13, 1997, court's order granting National Union's motion for an injunction enjoining the defendants from commencing or prosecuting any action affecting the proceeds of the policy is made permanent pursuant to 28 U.S.C. 2361, it is

Further Ordered and Adjudged, National Union is discharged from any further liability to the defendants with respect to the policy, the policy proceeds and any of its obligations in connection therewith, and that National Union is entitled to the policy proceeds, except as set forth in the judgment, it is

Further Ordered and Adjudged, that the bond submitted by National Union pursuant to 28 U.S.C. 1335 shall immediately be returned to the custody of the surety named therein and said surety and National Union are hereby released from any further obligation with respect to said bond; and, it is

Further Ordered and Adjudged, that National Union is obligated to reimburse or advance out of policy proceeds those

reasonable and necessary fees, costs and expenses which may be determined to be defense costs resulting solely from the investigation, adjustment, defense and appeal on behalf of Leonard A. Mr. Pelullo in the federal criminal action in the United States District Court for the Middle District of Florida [the Jacksonville Action]... and that the defense costs for the defense of Leonard Mr. Pelullo in the Jacksonville Action are to be paid as directed by the United States Bankruptcy Court for the Eastern District of Pennsylvania.

Since judgment was entered in the Interpleader Action, the first formal request pursuant to National Union's Policy for payment of costs for the defense of Leonard Pelullo in the Jacksonville Action was made in the United States Bankruptcy Court for the Eastern District of Pennsylvania in January of 1998.

Summary Judgment Standard

Presently before the Court is National Union's motion for summary judgment. Rule 56 of the Federal Rules of Civil Procedure provides that a court shall grant summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c).

The law is clear that when a motion for summary judgment

under Rule 56 of the Federal Rules of Civil Procedure is properly made, the non-moving party cannot rest on the mere allegations of the pleadings. Celotex Corp. v. Catrett, 477 U.S. 317 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986). Rather, in order to defeat the motion for summary judgment, the non-moving party, by its own affidavits, or by depositions, answers to interrogatories or admissions on file, as stated in Fed.R.Civ.P. 56(e), "must set forth specific facts showing that there is a genuine issue for trial." The Court, in determining whether there is a genuine issue of material fact, draws all inferences in favor of the non-moving party. Country Floors v. Partnership of Gepner and Ford, 930 F.2d 1056, 1061 (3d Cir. 1991). However, "[t]he mere existence of a scintilla of evidence" in support of the non-movant's position will not be sufficient to defeat a motion for summary judgment. Anderson, 477 U.S. at 252.

As stated above, in this civil action against National Union, Plaintiff alleges that National Union failed in bad faith to advance defense costs related to the Jacksonville Action, and in bad faith filed the Interpleader Action. Therefore, the only issue to be decided in connection with this summary judgment motion is whether or not Plaintiff has brought forth sufficient evidence establishing a genuine issue of material fact showing that National Union acted in bad faith in failing to advance the defense costs related to the Jacksonville Action and in filing

the Interpleader Action.

In opposition to Defendant's motion for summary judgment, Plaintiff has brought forth no affidavits, answers to interrogatories or admissions showing bad faith on the part of National Union. However, Plaintiff has attached two depositions, one of Kenneth Milbauer, who represented National Union at the time Mr. Pelullo was making his claims under the Policy, and the other of Leonard Pelullo himself. Having reviewed these depositions, together with the judgments of the U.S. District Court in Georgia in connection with the Interpleader Action and the deposition of David Talbert, Mr. Pelullo's attorney, attached to National Union's summary judgment motion, the Court, drawing all inferences in favor of the Plaintiff, finds that the evidence is insufficient to establish bad faith on the part of National Union, particularly since under Pennsylvania law, bad faith must be established by clear and convincing evidence.

In cases brought under Pennsylvania's bad faith statute, 42 P.S. § 8371, a plaintiff must show, by clear and convincing evidence, that the insurer lacked a reasonable basis for its denial of a claim, and that it knew of, or recklessly disregarded, the lack of a reasonable basis. Terletsky v. Prudential Prop. And Cas. Ins. Co., 649 A.2d 680, 688 (Pa.Super. 1994); MGA Ins. Co. v. Bakos, 699 A.2d 751, 754 (Pa.Super 1997). Because Plaintiff's burden in proving bad faith at trial is

higher than a preponderance of the evidence, Plaintiff's burden in opposing summary judgment is higher as well. Quaciari v. Allstate Insurance Company, 1998 WL 136509 (E.D.Pa.)(citing Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 254, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986)).

Pennsylvania's bad faith statute provides that

In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:

- (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%;
- (2) Award punitive damages against the insurer;
- (3) Assess court costs and attorney fees against the insurer.

42 P.S. § 8371.

The Pennsylvania Legislature did not define the term "bad faith"; in fact, "[t]here is no legislative history that specifically concerns this statute, which was enacted as part of a comprehensive insurance bill." Hyde Athletic Industries v. Continental Cas. Co., 969 F.Supp. 289 , 306 (E.D.Pa. 1997).

However, as Chief Judge Cahn has noted in Hyde, section 8371 "was passed by the Pennsylvania Legislature specifically to rectify the lack of a common-law remedy for bad faith conduct in denying an insured's claim." Id. Following the Pennsylvania Superior

Court in Terletsky, Chief Judge Cahn adopted Black's Law

Dictionary's definition of bad faith:

Insurance. "Bad faith" on [the] part of [an] insurer is 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.

Id.

The Plaintiff in this case has failed to present evidence sufficient to permit the Plaintiff's bad faith allegations to be submitted to a fact finder, particularly since, as stated above, the evidence of bad faith under Pennsylvania law must be clear and convincing, showing that National Union acted in bad faith in failing to advance to Mr. Pelullo the defense costs associated with the Jacksonville Action and in filing the Interpleader Action. The evidence brought forth by Plaintiff in the Milbauer deposition and the Pelullo deposition, together with the judgments of the U.S. District Court in Georgia in connection with the Interpleader Action and the Talbert deposition, attached to National Union's summary judgment motion, can be summarized as follows:

In September of 1993, W. David Talbert, II, an attorney representing Mr. Pelullo, sent a letter to National Union notifying National Union of Mr. Pelullo's multiple claims under

the Policy totaling several million dollars, including his claim for the advancement of defense costs related to the Jacksonville Action. By letter dated October 19, 1993, National Union's attorney, Kenneth Milbauer, acknowledged receipt of notice of Mr. Pelullo's claims, and responded that National Union would be treating Mr. Pelullo's claim for defense costs in the Jacksonville Action as a claim for which notice was timely given under the Policy.

Sometime in October or November of 1993, Mr. Talbert, Mr. Pelullo's attorney, orally proposed that National Union make a lump-sum payment of \$4 million under the Policy to settle all of Mr. Pelullo's claims (which included other claims in addition to those for defense costs related to the Jacksonville Action). By letter dated November 30, 1993, through its attorney Mr. Milbauer, National Union rejected this proposed settlement because there were competing claims against the Policy, including claims by the Trustee of the bankrupt estate of P-I-E, against various former directors and officers of P-I-E, including Mr. Pelullo. Mr. Milbauer's letter acknowledged that National Union was prepared to advance on behalf of Mr. Mr. Pelullo the reasonable and necessary legal fees and expenses incurred by him in defense of the Jacksonville Action, subject to the execution of an Interim Funding Agreement.

During the following months, from the end of 1993 to the

beginning of 1994, Mr. Talbert, Mr. Pelullo's attorney, continued to request that National Union advance defense costs related to the Jacksonville Action. According to Mr. Pelullo's deposition, he had no resources at this time and could not retain an attorney himself to protect his interests in the Jacksonville Action. Mr. Milbauer, National Union's attorney, testified at his deposition that National Union was aware during this time that Mr. Pelullo was claiming that his inability to challenge the validity of the Government's search and seizure of his business records, which had occurred in 1991 in connection with the investigation in the Jacksonville Action, would result in irreparable harm. According to Mr. Pelullo's deposition, the records seized by the Government were ultimately dispersed and used against him in other criminal and civil matters.

By letter dated January 13, 1994, Mr. Talbert, Mr. Pelullo's attorney, emphasized to National Union that there was some urgency in reaching an agreement regarding the defense costs. The letter proposed that Mr. Pelullo employ three law firms for the purpose of representing him in the Jacksonville Action. However, National Union did not advance the defense costs pursuant to Mr. Pelullo's demands because there were multiple, competing claims under the Policy, and there were negotiations among the various claimants for a global settlement of all claims. According to the deposition testimony of Mr. Milbauer,

National Union's attorney,

National Union was seeking to resolve, to the extent it could, the claims globally.... [With regard to] the claims made by Mr. Mr. Pelullo, [National Union] had adhered to its position that it was prepared to advance the defense costs, though it was discussing, at that point, global settlement of all claims.... National Union was very mindful of each of the individual insureds' rights under the policy, so that it attempted to, the best it could, under a complicated scenario, to be sure that each of the individual insureds, including Mr. Mr. Pelullo, had access to the stated asset.

By letter dated March 9, 1994, Mr. Pelullo, through his attorney Mr. Talbert, made yet another demand that National Union advance defense costs in connection with the Jacksonville Action, explaining once again that Mr. Pelullo faced adverse consequences if he remained unable to defend himself in the Jacksonville Action. Mr. Talbert estimated that the legal fees in connection with the recovery of these documents would be \$100,000.

According to Mr. Milbauer's deposition testimony, it continued to be National Union's position that National Union stood willing to advance the defense costs in the Jacksonville case, and that payment of the defense costs was not conditioned on a global settlement of the competing claims. However, according to Mr. Milbauer, given the multiple competing claims against the Policy, everybody, including Mr. Pelullo, was seeking a global settlement of the competing claims, and National Union did not fund Mr. Pelullo's defense costs at that time.

During the Spring of 1994, Mr. Pelullo, National Union and

the P-I-E Trustee engaged in negotiations to resolve the competing claims under the Policy. Sometime in the Spring of 1994, Mr. Pelullo and the P-I-E Trustee reached a "settlement in principle." However, this settlement was never finalized. In August of 1994, National Union filed the Interpleader Action. According to Mr. Pelullo, "National Union has never advanced any funds for my lawyers to represent me to defend against the Jacksonville action."

Having reviewed the depositions of Mr. Pelullo, Mr. Milbauer, and Mr. Talbert, together with the judgments of the U.S. District Court in Georgia in connection with the Interpleader Action, and having drawn all inferences in favor of the Plaintiff, it is clear that Plaintiff has produced insufficient evidence that National Union acted in bad faith in failing to advance the defense costs related to the Jacksonville Action or in filing the Interpleader Action, particularly since Pennsylvania law requires the evidence of bad faith to be clear and convincing. During the approximately ten months from the time Mr. Pelullo first gave notice of his claims under the Policy to the time National Union filed the Interpleader Action, there is no dispute that National Union faced multiple competing claims under the Policy in excess of the Policy limits. While National Union acknowledged the validity of Mr. Pelullo's claim for defense costs related to the Jacksonville Action from at least

November 30, 1993, National Union was reasonably concerned about maintaining the Policy limits until all of the competing claims were resolved. Furthermore, National Union, Mr. Pelullo and the other competing claimants were actively seeking a global settlement of all of the claims within the Policy limits. Plaintiff has failed to show that National Union's concern about the millions of dollars of competing claims above the Policy limits, and its desire to reach a settlement of those claims in order to protect the rights of all potential insureds, was unreasonable. The fact that Mr. Pelullo needed the defense costs immediately in order to protect his interests in the Jacksonville Action, and informed National Union of that fact, does not negate the reasonableness of National Union's concerns about the competing claims, and National Union's reluctance to fund any claim until all competing claims were resolved.

In addition, Plaintiff has failed to produce sufficient evidence, let alone clear and convincing evidence, that National Union acted in bad faith in filing the Interpleader Action. Statutory interpleader "is a remedial device which enables a person holding property or money to compel two or more persons asserting mutually exclusive rights to the fund to join and litigate their respective claims in one action." NyLife Distributors, Inc. v. Adherence Group, Inc., 72 F.2d 371, 374 (3rd Cir. 1995). There is no dispute that at the time it filed

the Interpleader Action, National Union faced multiple, competing claims on the Policy in excess of the Policy limits, precisely the dilemma statutory interpleader was designed to resolve. Plaintiff has offered insufficient evidence that National Union filed the Interpleader Action for any reason other than to resolve these competing claims.

In opposing National Union's summary judgment motion, Plaintiff bears the burden to "set forth specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e). "[T]here is no issue for trial unless there is sufficient evidence favoring the non-moving party for a jury to return a verdict for that party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249, 106 S.Ct. 2505, 2511 (1986). Plaintiff has failed to identify clear and convincing evidence which could cause a reasonable fact finder to conclude that National Union acted in bad faith when it did not advance the defense costs for the Jacksonville Action and when it filed the Interpleader Action. As Celotex teaches, "the plain language of Rule 56© mandates entry of summary judgment, after adequate time for discover and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Celotex, 477 U.S. at 322. Where the non-moving party fails to make such a showing with respect to an

essential element of its case, "there can be 'no genuine issue as to any material fact,' since a complete failure of proof concerning an essential element of a non-moving party's case necessarily renders all other facts immaterial." Id. at 323.

Because Plaintiff has failed to produce clear and convincing evidence of National Union's bad faith in failing to advance defense costs in connection with the Jacksonville Action and in filing the Interpleader Action, summary judgment will be granted in favor of Defendant National Union and against the Plaintiff.

An appropriate venue is ~~IN THE UNITED STATES~~ DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

DAVID EISENBERG, Chapter 7
Trustee for the Estate of
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v.

NATIONAL UNION FIRE INS. CO.
OF PITTSBURGH

CIVIL ACTION

NO. 97-5591

O R D E R

AND NOW, this 8th day of July, 1998; for the reasons set forth in this Court's accompanying memorandum dated July 8, 1998;

IT IS ORDERED: Summary Judgment is entered in favor of Defendant National Union Fire Insurance Company of Pittsburgh, Pennsylvania and against Plaintiff David Eisenberg, Chapter 7 Trustee for the Estate of Leonard A. Pelullo.

RAYMOND J. BRODERICK, J.