

RICHARD T. SCALIA and SERENA M. SCALIA, his wife, Plaintiffs,
v. ERIE INSURANCE EXCHANGE, Defendant
Court of Common Pleas of the 39th Judicial District of Pennsylvania,
Franklin County Branch
Civil Action - Law, No. 1999-20339, Jury Trial Demanded

Petition for attorney fees; 42 Pa.C.S.A. §2503

1. The court may award attorney fees as a sanction against those who knowingly raise and continue to litigate claims in bad faith which have no reasonable possibility of success and are filed solely to harass the opposing party and/or are pursued for a fraudulent, dishonest, or corrupt purpose.
2. The party seeking fees has the burden of proving its entitlement to those fees, and the court's decision on the matter should not be reversed absent a palpable abuse of discretion.
3. Defendant was awarded attorney fees spent to defend against a suit for breach of contract arising from its refusal to pay plaintiffs' insurance proceeds following an arson at their home; plaintiffs admitted at the civil trial to padding their claim for damages, and plaintiff-wife later pled guilty to insurance fraud for intentionally over-billing the defendant, with her plea constituting an admission that she filed and maintained the suit in bad faith and in an obdurate and vexatious manner.

Appearances:

Joan L. Stehulak, Esq., Counsel for Plaintiffs

Stephen L. Banko Jr., Esq., Counsel for Defendant

OPINION

Herman, J., August 18, 2004

Introduction

Before the court is a petition filed by Erie Insurance Exchange (Erie) for recovery of attorney fees. Erie incurred those fees in defending itself against an action for breach of contract and bad faith which the plaintiffs filed when Erie refused to pay them insurance monies under their homeowners' policy following a fire at their home. The plaintiffs answered the petition and the court received written and oral argument. The matter is ready for decision.

Background

A fire occurred at the plaintiffs' home on July 1, 1998. Erie was the plaintiffs' insurer under a homeowners' policy. Based on information gathered on the day of the fire, including interviews with the plaintiffs and a perusal of certain documents in their home, Erie began an in-depth investigation into the cause of the fire, which readily appeared to be arson. After concluding its investigation, Erie issued a letter to the plaintiffs on June 18, 1999 denying them benefits under the policy. What followed was this litigation in which the plaintiffs alleged that Erie's refusal to pay constituted a breach of the insurance contract, as well as bad faith under 42 Pa.C.S.A. §8371. Erie promptly retained counsel to defend against the suit.

The insurance policy provided that Erie would pay the plaintiffs the replacement value of the home and damaged contents once the plaintiffs made repairs. However, Erie was not obligated to pay if the

plaintiffs or someone acting at their direction intentionally caused the damage. Erie was also not required to pay if the plaintiffs intentionally concealed or misrepresented any material fact or circumstance concerning insurance coverage, or if they engaged in fraud or false swearing about any matter relating to the insurance coverage. Erie refused to pay benefits for two reasons. First, Erie maintained that the plaintiffs deliberately set the fire. Second, Erie concluded that the plaintiffs intentionally misrepresented their financial condition so as to mislead Erie into believing they lacked a motive to set the fire. The plaintiffs stipulated that the fire was indeed the result of arson but denied they were responsible for the fire.

During trial preparation, the plaintiffs produced a lengthy document outlining the costs they had allegedly incurred to repair their home. Defense counsel sought detailed discovery as to the authenticity and reasonableness of those costs. The plaintiffs provided defense counsel with approximately 400 pages of receipts, cancelled checks and related documents to support their repair claim. It was necessary for Erie to spend considerable time analyzing those documents in order to prepare for trial.

A five-day jury trial was held beginning on June 9, 2003. At its conclusion, the jury found Erie had not breached the contract. The verdict was recorded pursuant to Special Interrogatory #1, agreed to by counsel before its submission to the jury, which asked: "Do you find the Defendant, Erie Insurance Exchange, breached its contract to Plaintiffs?" Once the jury answered "No" to that interrogatory, it was unnecessary for them to answer additional interrogatories which appeared on the verdict slip -- interrogatories which counsel had also agreed to before deliberations began. Based on the evidence presented at trial, the jury's answer to this interrogatory was based on any or all of the following grounds: (1) Mr. or Mrs. Scalia committed arson by setting the fire or having someone set it for them; (2) the plaintiffs intentionally lied to Erie's investigators when they claimed that their finances were solid; and/or (3) the plaintiffs acted fraudulently in submitting repair bills to Erie which had nothing to do with restoring the home to its pre-fire condition. Any one of these grounds would have been sufficient for the jury to find that Erie was justified in refusing to pay insurance proceeds and had therefore not breached its contract with the plaintiffs.

The plaintiffs filed post-trial motions for judgment notwithstanding the verdict, which constituted a challenge to the sufficiency of the evidence supporting the verdict. The plaintiffs alternatively sought a new trial, an attack on the weight of the evidence supporting the verdict. The court denied the motions by Opinion and Order dated October 7, 2003 after considering written and oral argument. The plaintiffs did not appeal our ruling. They formally discontinued the entire action by withdrawing their remaining bad faith claim on or about December 8, 2003, a claim they had previously agreed to sever from the contract claim for trial purposes.

Erie thereafter filed this petition for attorney fees in the amount of \$48,455. The plaintiffs answered the petition, eventually conceding that the amount which Erie spent in counsel fees to defend itself was reasonable and necessary in light of the nature of the litigation and the length of the trial. That point having been conceded, counsel agreed that the record already developed in the case, plus written and oral argument, was sufficient for the court to rule. The court therefore did not hold an evidentiary hearing on Erie's petition.

Before the time set for oral argument, Mrs. Scalia pled guilty to one count of insurance fraud, a felony of the third degree. The plea proceeding and sentencing took place on February 18, 2004 before the Honorable John R. Walker, President Judge. Mrs. Scalia was sentenced to 84 months probation.^[1] As the basis for her plea, she admitted to having over-billed Erie for repair costs to the fire-damaged home in the approximate amount of \$14,000.

Discussion

Erie seeks to recover attorney fees which it expended to defend itself against the plaintiffs' civil action. The relevant statutory sections appear at 42 Pa.C.S.A. §2503(7) and (9):

The following participants shall be entitled to a reasonable counsel fee as part of the taxable costs of the matter:

...(7) Any participant who is awarded counsel fees as a sanction against another participant for dilatory, obdurate or vexatious conduct during the pendency of the matter.

...(9) Any participant who is awarded counsel fees because the conduct of another party in commencing the matter or otherwise was arbitrary, vexatious or in bad faith.

The aim of these provisions is to sanction those who knowingly raise and continue to litigate frivolous claims in bad faith which have no reasonable possibility of success and are pursued solely to

harass the opposing party. The provisions are not meant to punish all those who initiate legal actions which are not ultimately successful, but to prevent the filing and continuation of suits for the sole purpose of fraud, dishonesty or corruption. Thunberg v. Strause, 682 A.2d 295 (Pa. 1996); Berg v. Georgetown Builders, Inc., 822 A.2d 810 (Pa.Super. 2003).

The party seeking counsel fees has the burden of proving its entitlement to those fees. In re St. Clement's Church, 687 A.2d 11 (Pa.Cmwlth. 1996), *appeal denied*, 699 A.2d 737 (Pa. 1997). Whether to grant or deny a petition is within the trial court's discretion and should not be reversed unless the record shows that the trial court **palpably** abused that discretion. Thunberg, supra, at 615; In re Estate of Liscio, 638 A.2d 1019 (Pa.Super. 1994), *appeal denied*, 652 A.2d 1324 (Pa. 1994).

Erie presented three categories of evidence at trial. One category pertained to the plaintiffs' willingness and opportunity to set the fire on the morning of July 1, 1998. To that end, Erie demonstrated that the plaintiffs' home had been the scene of four prior fires, all of which were intentionally set. Erie also showed that Mrs. Scalia was the last person to leave the home on the morning of July 1, 1998, that she locked the doors behind her, and that smoke was seen coming from the house approximately 15 minutes after she left. Investigators found no sign of forced entry.

A second type of evidence consisted of extensive documents and testimony regarding the plaintiffs' financial circumstances, which was designed to show that the plaintiffs had a strong motive to set the fire. That motive was to obtain insurance proceeds in order to extricate themselves from an abysmal financial situation. The main issue was whether the plaintiffs deliberately lied by telling investigators that their business and personal finances were solid. A third category of evidence related to the plaintiffs' attempt to have Erie pay them for items which had nothing to do with restoring the home to its pre-fire condition. Erie placed evidence before the jury that the plaintiffs padded their repair claim by including costs associated with their business, and costs incurred in upgrading the home beyond its original condition at the time of the fire. Both these categories of evidence were introduced to prove that the plaintiffs engaged in fraud and misrepresentation in their dealings with Erie following the fire. Under the specific provisions of the policy, Erie was not obligated to pay benefits if the plaintiffs intentionally concealed or misrepresented any material fact or circumstance concerning insurance coverage, or engaged in fraud or false swearing about any matter relating to the insurance coverage.

When Erie investigators arrived at the plaintiffs' home on the day of the fire, the plaintiffs told them that their bills were current and that they were "rolling in the dough." (N.T. June 10, 2003, p. 66; June 12, 2003, p. 51.) Documents found in the home that day told another story, however. Erie found unpaid bills of many kinds pertaining to medical services, accounting services, credit cards, retail store bills, past due utility bills and shut off notices, letters concerning overdrawn bank accounts, mortgage delinquency notices, and a dunning notice from the I.R.S.

These documents led investigators to interview the plaintiffs under oath. Mr. Scalia told them that his business generated gross sales of \$700,000 in 1997 and that sales would probably reach \$1,000,000 in 1998. He described his relationship with his major customer as "beautiful." (N.T. June 10, 2003, p. 68.) However, tax returns and other documents clearly showed that the company generated only \$540,000 in sales in 1997. Furthermore, before the company went out of business in mid-late 1998, it generated only \$423,000 in sales. (N.T. June 10, 2003, pp. 62-63.)

Erie painstakingly analyzed an extensive amount of information and presented detailed evidence to the jury about the plaintiffs' dire financial situation during the months leading up to the July 1, 1998 fire. Contrary to Mr. Scalia's representations to Erie investigators, his company had severe cash flow problems and was the target of an I.R.S. levy for unpaid taxes, interest and penalties totaling \$58,000 dating back to 1997. The notice of levy was served on Mr. Scalia on June 10, 1998, just a few weeks before the fire. Mr. Scalia's main business customer all but ceased what had been its long-standing relationship with Mr. Scalia by the latter part of June 1998. According to Mr. Scalia's own testimony, that customer constituted 80% of his company's business. (N.T. June 10, 2004, pp. 59-60.) Bank records showed that Mr. Scalia's company bounced 32 checks during the month preceding the fire, and that two separate company accounts had negative balances on the day immediately before the fire.

Things were no better on the personal front. According to their bankruptcy petition filed after the fire, the plaintiffs had personal liabilities of \$320,000 before July 1, 1998, the date of the fire. That petition did not include debts associated with Mr. Scalia's company, the plaintiffs' sole source of income. Several local businesses had obtained civil judgments against the plaintiffs in connection with appliances and furnishings which the plaintiffs had acquired for their home.

The plaintiffs built their 3,500 square-foot home in 1996. Mrs. Scalia, who had a taste for high quality furnishings and decorative accents, outfitted the home without any real concern for the costs. (N.T., June 11, 2003, pp. 27-28.) The plaintiffs moved into the house in May of 1997, but it remained unfinished

both inside and outside and the plaintiffs often had trouble making timely mortgage payments. They decided in December 1997 to place the house on the market and did so the following month. When the house remained unsold, the plaintiffs lowered the price substantially in the spring, but had no interested buyers as of the end of June 1998.

The jury was also presented with evidence of the plaintiffs' general spending habits. Mrs. Scalia had several credit cards which she used to purchase a wide array of consumer goods such as clothing and expensive jewelry. (N.T. June 11, 2003, pp. 52-55.) It was her normal practice to obtain whatever items she wanted, either by check or credit card, without being concerned about whether she and Mr. Scalia's accounts could cover those expenditures. (N.T. June 11, 2003, pp. 62-63.) In 1998 when his business's reputation and cash flow were deteriorating, Mr. Scalia began to gamble several times a week. During this same period, Mrs. Scalia became pregnant with the couple's third child.

In addition to the above evidence pertaining to motive, opportunity and personal determination to set the July 1, 1998 fire, Erie presented extensive evidence of the plaintiffs' attempts to have Erie reimburse them for repair costs which were unrelated to restoring the home to its pre-fire condition. For example, the plaintiffs submitted bills for the installation of a swimming pool which they added to their property after the fire and which was not part of the original construction. The plaintiffs also sought payment for installing tile in two bathrooms, plywood, insulation, drywall, paint, air conditioning, equipment rentals and supplies for yard work, none of which were legitimate items of reimbursement, **as Mr. Scalia admitted** under pointed cross-examination at trial. In addition, the plaintiffs requested payment of bills and labor costs associated with their business which had no connection with the residence, **as admitted by Mr. Scalia** when he was confronted with documents which he provided to Erie during discovery. Erie produced this evidence to show that the plaintiffs committed insurance fraud, a ground for relieving Erie of its obligation to pay under the policy. (N.T. June 10, 2003, pp. 33-157; June 11, 2003, pp. 97-103.)

As set out above, Erie placed before the jury three types of evidence, any one of which was clearly sufficient to refute the plaintiffs' allegation that Erie violated the contract. The evidence pertaining to the plaintiffs' efforts to make Erie pay for costs wholly **and admittedly** unrelated to restoring their home to his pre-fire condition is particularly central to our consideration of Erie's petition for attorney fees. Erie was forced to spend an extensive amount of time during discovery and trial preparation analyzing at least 400 pages of billing documents connected with the plaintiffs' false insurance claims, and to effectively cross-examine the plaintiffs on those documents.

Furthermore, several months after the civil trial, Mrs. Scalia **pled guilty** (not "no contest") to one count of insurance fraud arising out of this deliberate and intentional over-billing. Her plea constituted an admission that the civil suit was filed and pursued in bad faith, i.e., for the sole purpose of fraud, dishonesty, or corruption. This conduct was also clearly vexatious and obdurate in the sense that the plaintiffs must have known when they commenced and continued the civil action that Erie was completely justified in denying their insurance claim, and had **not** breached its contract with them. The plaintiffs' conduct is precisely the sort of conduct envisioned by 42 Pa.C.S.A. §§2503(7) and (9). We find, based on the arguments of counsel, the entire record in the case, and the relevant case law and statutory authority, that Erie has met its burden of proving its entitlement to counsel fees under the statute.

ORDER OF COURT

Now this 18th day of August 2004, the court hereby grants the petition filed by Erie Insurance Exchange for counsel fees which it incurred to defend against the above-captioned civil action, in the amount of \$48,455.00.

[1] The court ordered Mrs. Scalia to perform community service, but did not require her to pay any restitution.