

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

EMERSON HALL ASSOCIATES, L.P.,

Plaintiff,

v.

OPINION & ORDER

TRAVELERS CASUALTY INSURANCE COMPANY
OF AMERICA,

15-cv-447-jdp

Defendant.

This is an insurance dispute between plaintiff Emerson Hall Associates, L.P. and defendant Travelers Casualty Insurance Company of America. Emerson Hall initially alleged breach of contract and bad faith because Travelers refused to pay part of Emerson Hall's claim under an insurance policy. Travelers responded with a counterclaim for breach of contract, alleging that Emerson Hall had fraudulently induced Travelers to pay part of the claim. Now Emerson Hall wants to call and raise: it has moved to amend its pleadings to allege that Travelers' counterclaim is evidence of the insurance company's bad faith.

Travelers opposes Emerson Hall's motion as untimely and futile. After reviewing the parties' submissions and the proposed amended complaint, the court will grant Emerson Hall leave to amend. But the court will limit the scope and import of the new allegations. This case is about whether Travelers properly denied part of Emerson Hall's claim and whether Emerson Hall fraudulently induced Travelers to pay other portions of that claim. The court will not allow Emerson Hall to assert defamation-like claims based on Travelers's counterclaim in this case.

BACKGROUND

The court draws the following factual allegations from Emerson Hall's complaint and proposed amended complaint, accepting them as true at this point in the case.

Emerson Hall owns an apartment complex in Beloit, Wisconsin, and it insured the building with Travelers. In September 2013, a fire broke out in the apartment complex, and about two months later, a pipe burst and caused water damage. Travelers determined that both the fire damage and the water damage were caused by events that were covered under Emerson Hall's insurance policies. Emerson Hall submitted a claim for its losses and hired construction and remediation companies to repair the building. By December 2014, the building had been repaired.

Emerson Hall alleges that Travelers breached the parties' insurance contract in several ways. First, Travelers determined the replacement costs for the losses that Emerson Hall had suffered, but it did not pay Emerson Hall those amounts. Instead, Travelers withheld a "depreciation holdback" and paid Emerson Hall the actual cash value for its losses. Even after Emerson Hall repaired the building, Travelers refused to pay the amounts that it had withheld for depreciation. Second, Travelers refused to cover Emerson Hall's construction costs for complying with ordinances, as well as demolition charges, utilities, and other expenses. Third, Travelers limited payments for extended lost business income.

In June 2015, Emerson Hall filed suit in Wisconsin Circuit Court for Rock County, alleging claims against Travelers for breach of contract and bad faith. Travelers removed the case to this court on the basis of diversity. After the parties addressed jurisdictional issues, the court determined that Travelers had properly invoked the court's diversity jurisdiction pursuant to 28 U.S.C. § 1332. Dkt. 24.

The case got sidetracked in the months that followed because Emerson Hall's counsel withdrew, a third party moved to intervene (and then decided to not intervene after the court granted its motion), and Travelers moved for leave to file a counterclaim for breach of contract. When the dust settled, Emerson Hall had new counsel, Travelers had new pleadings, and the case had new deadlines and a new trial date.

Emerson Hall has now moved for leave to file an amended complaint.

ANALYSIS

Under Federal Rule of Civil Procedure 15(a)(2), the court must freely grant Emerson Hall leave to amend "when justice so requires." "Although the rule reflects a liberal attitude towards the amendment of pleadings, courts in their sound discretion may deny a proposed amendment if the moving party has unduly delayed in filing the motion, if the opposing party would suffer undue prejudice, or if the pleading is futile." *Campania Mgmt. Co. v. Rooks, Pitts & Poust*, 290 F.3d 843, 848-49 (7th Cir. 2002). Here, Travelers contends that Emerson Hall's motion is untimely and futile. The court disagrees and will therefore grant Emerson Hall leave to amend. But Travelers raises legitimate concerns about the scope of Emerson Hall's proposed new allegations, and so the court will clarify what is and is not at issue in Emerson Hall's bad faith claim.

Emerson Hall's proposed amended complaint is essentially a response to Travelers's counterclaim. In the counterclaim, Travelers alleged that during the course of this litigation, it learned that Emerson Hall made several fraudulent statements with regard to securing the insurance policies at issue and submitting claims under those policies. *See generally* Dkt. 34, ¶¶ 66-142. Emerson Hall now wants to allege that the allegations in the counterclaim are not

only false, but that they are also evidence of Travelers's trumped-up reasons for denying coverage. Emerson Hall contends that these allegations support its bad faith claim.

Emerson Hall has not unduly delayed in moving to amend its complaint. This case began in state court on June 10, 2015, and Travelers removed the case about a month later. Dkt. 2 and Dkt. 2-3. In December 2015, Emerson Hall's counsel moved to withdraw and Travelers moved to file an amended answer with a counterclaim. Dkt. 26 and Dkt. 28. The court granted Travelers leave to amend, but it was not until March 2016 that Emerson Hall's new counsel appeared. Dkt. 42 and Dkt. 43. On March 23, 2016, Emerson Hall filed both a reply to Travelers's counterclaim and a motion for leave to file an amended complaint. Dkt. 44 and Dkt. 45. Travelers's counterclaim was the impetus for Emerson Hall's amended complaint, and Emerson Hall's lack of counsel explains the two-month gap between the counterclaim and the motion to amend. Moreover, the proposed amendments are not adding new claims, just new allegations to support existing claims.¹ Thus, any prejudice from Emerson Hall's delay is virtually non-existent. Under these circumstances, the court concludes that Emerson Hall has acted quickly enough to allow amendment under Rule 15.

Travelers's principal objection to the proposed amended complaint is that it appears to expand Emerson Hall's bad faith claim to assert liability against Travelers for defamatory statements in the counterclaim. Under Wisconsin law, "defamatory words published or spoken by parties, witnesses and counsel are absolutely privileged when the statements bear a proper relationship to the issues. . . . Likewise, parties and counsel are immune from liability

¹ Travelers is concerned that Emerson Hall may be trying to assert a defamation claim. *See* Dkt. 49, at 5. But there is no defamation claim in the proposed amended complaint, *see generally* Dkt. 47-1, and Emerson Hall affirmatively indicates that it is not pursuing such a claim against Travelers, Dkt. 50, at 8.

for relevant statements in pleadings and otherwise in the course of judicial proceedings.” *Bergman v. Hupy*, 64 Wis. 2d 747, 221 N.W.2d 898, 900 (1974) (citations and internal quotation marks omitted). Travelers contends that this absolute litigation privilege renders Emerson Hall’s proposed amendments futile because Travelers cannot be held liable for the allegations in its counterclaim. Emerson Hall’s response is two-fold: it argues that the bad faith claim is not based solely on the fact that Travelers filed a counterclaim, and that, regardless, Wisconsin law permits insureds to base bad faith claims on their insurers’ litigation tactics.

To state a first-party bad faith claim (i.e., an insured’s claim that its insurer had no justification to deny a claim), Emerson Hall must allege “the absence of a reasonable basis for denying benefits of the policy and [Travelers]’s knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. The knowing failure of an insurer to proceed in a manner that is honest and informed constitutes bad faith.” *Brethorst v. Allstate Prop. & Cas. Ins. Co.*, 2011 WI 41, ¶ 26, 334 Wis. 2d 23, 798 N.W.2d 467 (citations and internal quotation marks omitted). Emerson Hall adequately alleged this type of bad faith claim in its initial complaint. Dkt. 23-1, ¶¶ 33-38. Now that Travelers has filed a counterclaim identifying Emerson Hall’s fraud as a possible basis for not paying benefits, Emerson Hall wants to supplement its initial allegations to refute Travelers’s justification. Put differently, Emerson Hall’s proposed amended complaint is designed to preempt any argument that it defrauded Travelers or that the actions that Travelers perceived to be fraudulent provided a reasonable basis for denying Emerson Hall’s claim for benefits.² This amendment does not

² It is not clear that Emerson Hall actually needed to amend its complaint to address these issues. It could have responded to them in its reply to Travelers’s counterclaim or at summary judgment or trial.

widen the scope of Emerson Hall's bad faith claim, and it may help narrow the issues in this case and streamline discovery. The court will therefore grant Emerson Hall's motion to amend.

But as to Emerson Hall's second point—that it can assert a bad faith claim based exclusively on Travelers's decision to file a counterclaim—an amendment for this purpose *would* widen the scope of the bad faith claim. Emerson Hall contends that Wisconsin courts have imposed liability on insurance companies for their conduct in litigation. But the two cases to which Emerson Hall cites are distinguishable. In *Trinity Evangelical Lutheran Church & School-Freistadt v. Tower Insurance Company*, an insurance company learned about a mutual mistake that had occurred in placing a policy, but then failed to inform the trial court about the mistake. 2003 WI 46, ¶ 42, 261 Wis. 2d 333, 661 N.W.2d 789. Although the supreme court concluded that the insurance company had acted in bad faith, the court's analysis turned on the insurance company's refusal to acknowledge that the mutual mistake required it to pay benefits, as well as on the fact that the company knew about the mistake when it actually denied benefits. *Id.* ¶¶ 39-43. Contrary to Emerson Hall's contention, Dkt. 50, at 5, *Trinity* does not stand for the proposition that an insurer's litigation tactics, alone, can give rise to a bad faith claim.

Likewise, in *General Casualty Company of Wisconsin v. Choles*, the Wisconsin Court of Appeals concluded that an insurance company had acted in bad faith when it filed a motion for summary judgment arguing that the policy at issue should not be reformed based on mutual mistake. 2010 WI App 62, ¶ 34, 324 Wis. 2d 583, 785 N.W.2d 687. Taken out of context, some of the court of appeals's statements might support Emerson Hall's position in this case. But read as a whole, *Choles* addressed essentially the same issue that *Trinity*

addressed: an insurance company learned of a mutual mistake in placing the policy at issue, refused to acknowledge that the mistake required reformation of the policy, and failed to pay a claim. *Id.* ¶¶ 25-35. Neither case discussed whether an insurance company can be held liable for a bad faith claim based solely on the contents of its pleadings.

The fundamental difference between this case and the cases to which Emerson Hall cites is that Travelers's litigation tactic (i.e., its counterclaim) does not appear to relate to its decision to deny benefits. Travelers answered Emerson Hall's complaint by denying that the terms of the insurance policy covered all of the claimed losses and by affirmatively alleging that Emerson Hall was entitled to only the payments that it received. Dkt. 34, ¶¶ 30, 55, 57. In contrast, the counterclaim alleged that for the benefits that Travelers *did* pay, Emerson Hall had fraudulently misrepresented its entitlement to benefits, and so Travelers should recover those payments as damages for breach of contract. *Id.* ¶¶ 139-41. In this context, Emerson Hall cannot base a new bad faith claim on—or prove its existing bad faith claim with—the fact that Travelers has filed a counterclaim.

The court will grant Emerson Hall's motion for leave to amend with two important caveats. First, as Emerson Hall has represented to the court, the amended complaint does not assert a claim for defamation. Second, Emerson Hall may not add a new bad faith claim based on Travelers's decision to file a counterclaim, nor may Emerson Hall rely on the counterclaim to prove its existing bad faith claim.

ORDER

IT IS ORDERED that plaintiff Emerson Hall Associates, L.P.'s motion for leave to file amended complaint, Dkt. 45, is GRANTED. Plaintiff should file its proposed amended complaint as a separate docket entry.

Entered April 21, 2016.

BY THE COURT:

/s/

JAMES D. PETERSON
District Judge