In the United States District Court
for the Southern District of Georgia
Brunswick Division

STATE FARM FIRE & CASUALTY COMPANY,	*	
Plaintiff,	*	
vs.	*	CV 209-096
KENNETH WAITHE, LINDA WAITHE, ARROWHEAD CLINIC, INC., ARROWHEAD MANAGEMENT, INC, HARRY W. BROWN, INC., H. BROWN MANAGEMENT COMPANY, LLC, and HARRY W. BROWN, JR,	*	
Defendants.	*	

Order

This declaratory judgment action is brought by State Farm Fire & Casualty Company ("State Farm") against its insureds, Arrowhead Clinic, Inc., Arrowhead Management, Inc., Harry W. Brown, Inc., H. Brown Management Company, LLC, and Harry W. Brown, Jr. (collectively referred to as the "Arrowhead and Brown Defendants"), and Kenneth and Linda Waithe, the plaintiffs in an underlying litigation against the Arrowhead and Brown Defendants. Presently before the Court are the Arrowhead and Brown Defendants' Motion to Stay Proceedings (Dkt. No. 19), State Farm's Motion for Summary Judgment (Dkt. No. 24), and the

Arrowhead and Brown Defendants' Motion for Partial Summary Judgment (Dkt. No. 26).

The Arrowhead and Brown Defendants' Motion to Stay is **DENIED AS MOOT**. That Motion is predicated on a certiorari petition filed in the Supreme Court of Georgia. The Supreme Court of Georgia denied certiorari, rendering the Motion to Stay moot. State Farm's Motion for Summary Judgment is **GRANTED IN PART** and **DENIED IN PART**. State Farm is entitled to summary judgment on the Arrowhead and Brown Defendants' Counterclaims, but not State Farm's duty to defend. The Brown and Arrowhead Defendants' Motion for Summary Judgment is **GRANTED**. State Farm has a duty to defend the Arrowhead and Brown Defendants in the Waithes' underlying lawsuit.

I. Background

State Farm seeks a declaration that it does not have a duty to defend the Arrowhead and Brown Defendants in an action brought against them by the Waithes. The Arrowhead and Brown Defendants rely heavily on a collateral estoppel argument in support of their coverage position.

A. The Underlying Lawsuit

Kenneth and Linda Waithe originally filed suit against the Arrowhead and Brown Defendants, as well as various attorneys and law firms who are not parties to this action, in the State Court

of Liberty County, Georgia. The Court will refer to that lawsuit as the "underlying litigation" throughout this Order. The defendants in the underlying litigation removed the case to the United States District Court for the Southern District of Georgia, Savannah Division, and the Waithes amended their complaint to drop Harry W. Brown, Sr. as a defendant. The Court will refer to the Waithes' first amended complaint in the underlying litigation (Dkt. No. 1-1) as the "underlying complaint."

In the underlying complaint, the Waithes assert various causes of action on behalf of themselves and others similarly situated against the Arrowhead and Brown Defendants, Robert Stein, Stein & Associates, and Legal Counsel, Inc. (collectively referred to as the "Stein Firm"). The underlying complaint includes the following allegations:

> The Arrowhead and Brown Defendants operate chiropractic clinics. They had a practice of contacting the Stein Firm when a patient visited a chiropractic clinic to seek treatment for an injury caused by a car accident or tort. (*Id.* ¶ 29.) The Arrowhead and Brown Defendants did not obtain the patient's consent before contacting the Stein Firm. (*Id.*)
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> Before leaving the clinic, new patients were told to meet with a representative of the Stein Firm in the chiropractic clinic.[1] (*Id.*) The representative of the Stein Firm would present the patient with an attorney-client contract and encourage the patient to

[1] The underlying complaint does not say who told the patients to meet with the representatives of the Stein Firm.

> sign it. (*Id.*) All of the contracts provided that the attorney would be compensated on a contingency-fee basis and granted the attorney an irrevocable right to pay the patient-client's medical expenses - including chiropractic fees. (*Id.*) The Brown and Arrowhead Defendants would then overbill for their chiropractic services, and the Stein Firm would pay the bill out of settlement or insurance proceeds obtained through its representation of the patient. (*Id.* ¶ 30.) The Stein Firm and the Arrowhead and Brown Defendants thus had a symbiotic relationship. The Stein Firm was able to solicit accident victims and sign them up as clients, and the Arrowhead and Brown Defendants were able to collect inflated bills. (*Id.*)

The Waithes assert eight substantive claims for relief in the underlying complaint. (*Id.* ¶¶ 36-68.) Most relevant to this action are counts two, five, and six. In those three counts, the Waithes accuse the Arrowhead and Brown Defendants of violating their privacy rights. (*Id.* ¶¶ 45, 57, 63.) The Arrowhead and Brown Defendants demanded that their insurer, State Farm, provide them with a defense to the Waithes' underlying complaint. State Farm agreed to provide a defense, but did so under a full reservation of rights. Pursuant to the reservation of rights, State Farm preserved its ability to challenge coverage.

B. The Insurance Policies

State Farm issued at least four insurance policies to the Arrowhead and Brown Defendants. Three of the policies provide,

inter alia, commercial liability coverage, and the fourth provides umbrella coverage:

> 1. Policy No. 91-CT-7319-2, issued to Arrowhead Clinics, Inc. and Arrowhead Management, Inc. (Dkt. No. 1-2);
> 2. Policy No. 91-BL-4800-9, issued to Harry W. Brown, Inc. and Arrowhead Management, Inc. (Dkt. No. 1-3);
> 3. Policy No. 91-PG-6789-0, issued to H. Brown Management Company, LLC (Dkt. No. 1-4); and
> 4. Policy No. 91-BL-0133-9 (the umbrella policy), issued to Arrowhead Management, Inc., Arrowhead Clinics, Inc., and Harry W. Brown, Inc. (Dkt. No, 1-5).

Although the individual policies were issued to different Arrowhead and Brown Defendants, the provisions relevant to State Farm's Declaratory Judgment Action are identical.

Each policy includes a duty to defend: "We [State Farm] will have the right and duty to defend any claim or **suit** seeking damages payable under this policy even though the allegations of the **suit** may be groundless, false or fraudulent." (*See, e.g.*, Dkt. No. 1-2, 27) (emphasis in original). Each policy also covers "personal injury" and "advertising injury." (*Id.*) The policies define "personal injury" as "injury, other than **bodily injury**, arising out of one or more of the following offenses: . . . oral or written publication of material that violates a person's right of privacy." (*Id.* at 39) (emphasis in original). The policy defines "advertising injury" as "injury arising out of one or more of the following offenses: . . . oral or written

publication of material that violates a person's right of privacy." (*Id.* at 37.) In order to trigger advertising injury coverage, the "**occurrence** must be committed in the course of advertising [the insured's] goods, products, or services." (*Id.* at 27.) The Parties disagree over whether the underlying complaint alleges an advertising injury, but agree that it alleges a personal injury.

Though the Parties agree that the underlying complaint alleges a personal injury, they disagree over whether the penal law exclusion contained in the policies applies. The penal law exclusion applies to both personal injury and advertising injury coverage. It excludes coverage for claims "arising out of the willful violation of a penal statute or ordinance committed by or with the consent of the insured." (*Id.* at 31.)

C. The Chatham County Action

This is not the first time State Farm and the Arrowhead and Brown Defendants have litigated the penal law exclusion. The Brown and Arrowhead Defendants were sued by a different set of plaintiffs in Chatham County Superior Court. The Court will refer to that lawsuit as the "Chatham County action" throughout this Order. The plaintiffs in the Chatham County action asserted claims substantially similar to the ones asserted by the Waithes in their underlying complaint. The Arrowhead and Brown Defendants also sought coverage under the insurance

policies issued by State Farm. State Farm agreed to defend, but under a reservation of its rights to deny coverage.

State Farm then filed a declaratory judgment action against the Arrowhead and Brown Defendants, also in the Chatham County Superior Court. The same insurance policies at issue here were at issue in the Chatham County action, and State Farm pursued the same coverage theory: that the penal law exclusion excludes coverage because the alleged privacy right violations also constitute a violation of the Health Insurance Portability and Accountability Act of 1996 ("HIPAA").[2] The Superior Court of Chatham County rejected that position because the plaintiffs alleged a violation of common law privacy rights, not a violation of HIPAA. (Dkt. No. 32-1, 10.) The Georgia Court of Appeals affirmed in an unpublished disposition, and the Supreme Court of Georgia denied certiorari.

II. Discussion

Summary judgment is appropriate when there are no disputed issues of material fact and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The party seeking summary judgment can discharge its initial burden by demonstrating the absence of a material issue of fact for an essential element of which the opposing party bears the burden

[2] Specifically, State Farm claims that the alleged privacy violations also constitute a violation of 42 U.S.C. § 1320d-6, a criminal provision of HIPAA.

of proof. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87& n.10, 106 S. Ct. 1348 (1986). The opposing party must then put forth evidence sufficient to enable a "rational trier of fact" to find in its favor. *Id.* at 587. The Court must determine whether the trier of fact could reasonably find in the nonmovant's favor. *Reeves v. Sanderson Plumbing Prods., Inc.*, 530 U.S. 133, 150, 120 S. Ct. 2097 (2000). In so determining, the Court "may not make credibility determinations or weigh the evidence." *Id.* The Court first determines whether State Farm owes the Arrowhead and Brown Defendants a duty to defend, then turns to the Arrowhead and Brown Defendants' Counterclaims.

A. Duty to Defend

State Farm's Motion presents the question of whether it has a duty to defend the Arrowhead and Brown Defendants. Under Georgia law, the duty to defend is significantly broader than the duty to indemnify. The insurer owes its insured a duty to defend if the allegations set forth in the complaint arguably allege a covered loss. *See Nationwide Mut. Ins. Co. v. Somers*, 264 Ga. App. 421, 423-24, 597 S.E.2d 430 (2003). Matters outside of the complaint are only considered if the insured makes the insurer aware of "true facts" that entitle the insured to coverage. *See Colonial Oil Indus. v. Underwriters*

Subscribing to Policy Nos. T031504670 & T031504671, 268 Ga. 561, 562, 491 S.E.2d 337 (1997).

The principle issue presented by the Parties' Motions is whether the penal law exclusion applies. State Farm concedes that the Waithes' complaint in the underlying lawsuit against the Arrowhead and Brown Defendants includes allegations of a personal injury - a violation of the Waithes' privacy rights. State Farm argues that because the Waithes' common law privacy claims would also constitute a violation of the criminal provisions of HIPAA, the penal law exclusion applies, and State Farm does not owe the Arrowhead and Brown Defendants a duty to defend.[3] Defendants note that the Waithes have not alleged a violation of HIPAA. The Arrowhead and Brown Defendants also claim that State Farm is precluded from denying its duty to defend based on the penal law exclusion under the doctrine of collateral estoppel. The Court agrees. The Arrowhead and Brown Defendants' Motion for Partial Summary Judgment (Dkt. No. 26) is therefore **GRANTED**.

Federal courts give preclusive effect to state court judgments if "the courts of the state from which the judgment emerged would do so themselves" and the litigants have had a

[3] The Parties also disagree over whether the Waithes have alleged an "advertising injury." The Court does not need to resolve that dispute at this time because the penal law exclusion also applies to advertising injury coverage, and it is undisputed that the Waithes have alleged a "personal injury."

"full and fair opportunity" to be heard. *Shields v. BellSouth Adver. & Publ'g Co., Inc.*, 228 F.3d 1284, 1288 (11th Cir. 2000) (internal quotation marks omitted). '"Collateral estoppel, like res judicata, requires identity of parties or privity. However, unlike res judicata, collateral estoppel does not require identity of the claim but only precludes readjudication of an issue already adjudicated between the parties or their privies in a prior action.'" *Burnett v. Slatter*, 286 Ga. 169, 172, 686 S.E.2d 126 (2009) (quoting *Hardwick v. Williams*, 272 Ga. App. 680, 682, 613 S.E.2d 215 (2005)). Importantly, res judicata and collateral estoppel do "not require that all parties on the respective sides of litigation in both cases be identical, but only those by and against whom the defense of res judicata [or collateral estoppel] is invoked." *Waggaman v. Franklin Life Ins. Co.*, 265 Ga. 565, 566, 458 S.E.2d 826 (1995).

The requirements of collateral estoppel are met in this case. The Parties asserting collateral estoppel - the Arrowhead and Brown Defendants - and the Party against whom it is asserted - State Farm - were parties to the Chatham County action. The fact that the Waithes were not parties to the Chatham County action is irrelevant under *Waggaman*.

The Superior Court of Chatham County held "that since the [the plaintiffs in the underlying lawsuit] made no allegations of a violation of HIPPA [sic], [State Farm] cannot use that as

the basis for the exclusion of insurance under the policy." (Dkt. No. 32-1, 10.) The court also concluded that State Farm owed the Arrowhead and Brown Defendants a duty to defend. The Georgia Court of Appeals affirmed in an unpublished disposition, and the Supreme Court of Georgia denied certiorari. State Farm concedes that the coverage issues in the Chatham County action are substantially similar to those at issue here. They are, in fact, identical. State Farm claimed that the penal law exclusion applies, while the Arrowhead and Brown Defendants claimed that the exclusion did not apply because the plaintiffs in the underlying action did not allege a HIPAA violation. State Farm had a full and fair opportunity to litigate the issue in the state courts, but lost. It cannot now obtain a different result in federal court. The Arrowhead and Brown Defendants are parties in both cases, and are therefore entitled to the benefits of the state court decisions. The Court therefore holds that State Farm has a duty to defend the Arrowhead and Brown Defendants in the Waithes' underlying lawsuit.[4]

B. The Arrowhead and Brown Defendants' Counterclaims

The Arrowhead and Brown Defendants assert three Counterclaims in their Answer: (1) Breach of Contract; (2) Bad Faith; and (3) Interest and Attorney Fees. State Farm is entitled to summary judgment on all three.

[4] Whether State Farm owes any of the Defendants a duty to indemnify is not ripe for adjudication.

The Arrowhead and Brown Defendants allege in Count One of their Counterclaim that State Farm breached its duty to defend and indemnify them in the Waithes' underlying lawsuit. As an initial matter, State Farm's duty to indemnify has not yet arisen, so that portion of Count One is not ripe. As the Waithes point out in their briefs, there are many possible outcomes to their underlying lawsuit that could trigger differing duties to indemnify under the various insurance policies issued by State Farm. It is simply too early to determine the existence or scope of a duty to indemnify. Regarding the duty to defend, State Farm *is* defending the Arrowhead and Brown Defendants under a reservation of rights. State Farm is therefore in compliance with its duty to defend. Count One of the Counterclaim therefore fails as a matter of law.

The Arrowhead and Brown Defendants allege in Count Two of their Counterclaim that State Farm has acted in bad faith by refusing to provide liability coverage after the state courts ruled against it in the Chatham County action. Defendants are wrong on multiple levels. For one, State Farm filed a petition for a writ of certiorari in the Supreme Court of Georgia seeking to have the Superior Court of Chatham County's decision reversed. The Supreme Court ultimately denied the petition, but not until after State Farm filed the instant action. Second,

defending a lawsuit under a reservation of rights and filing a declaratory judgment is not evidence of bad faith. *See Morrill v. Cotton States Mut. Ins. Co.*, 293 Ga. App. 259, 264-65, 666 S.E.2d 582 (2008).

In Count Three of their Counterclaim, the Arrowhead and Brown Defendants seek attorney's fees and expenses under O.C.G.A. §§ 13-6-11 and 33-4-6. O.C.G.A. § 13-6-11 provides that a party may recover litigation expenses from another party who "in bad faith, has been stubbornly litigious, or has caused the plaintiff unnecessary trouble and expense." Section 33-4-6 authorizes recovery of litigation expenses against an insurer who, in bad faith, refuses to pay a claim after sixty-days' notice of the claim. The Arrowhead and Brown Defendants are not entitled to recover under either statute.

As stated above, State Farm did not act in bad faith in bringing the instant declaratory judgment action. While the Superior Court of Chatham County and Georgia Court of Appeals had already ruled against it, State Farm believed that the Supreme Court of Georgia would grant certiorari and reverse. That belief, while ultimately incorrect, does not rise to the level of bad faith. There are many possible interpretations of the penal law exclusion. State Farm argued for the broadest possible interpretation; Defendants argued for a much narrower interpretation. Both have textual support, as do many other

possible interpretations. It was certainly possible that the Supreme Court of Georgia would adopt a broader interpretation of the exclusion than did the Superior Court. The Court therefore holds that the Arrowhead and Brown Defendants are not entitled to litigation expenses under O.C.G.A. § 13-6-11.

The Arrowhead and Brown Defendants are not entitled to expenses or penalties under O.C.G.A. § 33-4-6 because State Farm has not refused to pay a claim. Rather, State Farm agreed to defend under a reservation of rights while this Court decided whether it has a duty to defend. Continuing to provide a defense under a reservation of rights while seeking a declaratory judgment is not bad faith. *See Morrill*, 293 Ga. App. at 264-65. The Court therefore holds that the Arrowhead and Brown Defendants are not entitled to penalties or expenses under O.C.G.A. § 33-4-6. Accordingly, State Farm's Motion for Summary Judgment (Dkt. No. 24) is **GRANTED** with respect to the Arrowhead and Brown Defendants' Counterclaims.

III. Conclusion

The Arrowhead and Brown Defendants' Motion to Stay Proceedings (Dkt. No. 19) is **DENIED AS MOOT**. State Farm's Motion for Summary Judgment (Dkt. No. 24) is **GRANTED IN PART** and **DENIED IN PART**. State Farm's Motion is granted with respect to the Arrowhead and Brown Defendants' Counterclaims but denied

with respect to State Farm's duty to defend. The Arrowhead and Brown Defendants' Motion for Partial Summary Judgment (Dkt. No. 26) is **GRANTED**. State Farm owes the Arrowhead and Brown Defendants a duty to defend. The Clerk of Court is hereby Ordered to enter appropriate relief and is authorized to close this case.

SO ORDERED, this 16 day of July, 2010.

LISA GODBEY WOOD, CHIEF JUDGE
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF GEORGIA