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The ever-expanding genuine-dispute doctrine, and how to deal with it

The legal equivalent of kudzu

The genuine-dispute doctrine has become the legal equivalent of kudzu – an invasive species known for its explosive growth. "[T]he genuine dispute doctrine 'holds that an insurer does not act in bad faith when it mistakenly withholds policy benefits, if the mistake is reasonable or is based on a legitimate dispute as to the insurer's liability." (*Delgado v. Interinsurance Exch. of the Automobile Club of So. California* (2007) __ Cal.App.4th __, __, __ Cal.Rptr.3rd __, [2007 WL 1810226], citing *Century Surety Co. v. Polisso* (2006) 139 Cal.App.4th 922, 949 [43 Cal.Rptr.3rd 468].)

This doctrine has become the first line of defense relied on by insurance companies who have been sued for insurance bad-faith in California. As originally adopted it was a tool that allowed trial courts to grant summary judgment in appropriate first-party, bad-faith cases, when there was a "genuine dispute" about the controlling legal principles that governed the claim. But in the last five or six years, its use has expanded to virtually every aspect of bad-faith litigation.

It now applies to factual, as well as legal disputes (*Guebara v. Allstate Ins. Co.* (9th Cir. 2001) 237 F.3d 987, 993-994; *Chateau Chamberay Homeowners Association v. Assoc. International Ins. Co* (2001) 90 Cal.App.4th 335, 348 [108 Cal.Rptr.2d 776]); to third-party as well as first-party claims (*Delgado v. Interinsurance Exch. of the Automobile Club of So. California*, __ Cal.App.4th at __ [2007 WL 1810226 at *11], and to judgments entered for the insurer based on a demurrer (*Rappaport-Scott v. Interinsurance Exchange of the Automobile Club* (2007) 146 Cal.App.4th 831, 839 [53 Cal.Rptr.3rd 245].) And even though it has principally been used as a means to justify summary judgment – meaning that a finding of a genuine-dispute is a legal issue determined by the trial court – recently-proposed modifications to the CACI bad-faith instructions would, in some cases, ask the jury to determine whether there was a genuine dispute. (These proposals are still under consideration by the Judicial Council.)

Old-school bad faith

It was not always this way. The existence of a "genuine issue" as a basis to defeat a bad-faith claim was recognized until 1982, in *Safeco Ins. Co. of America v. Guyton* (9th Cir. 1982) 692 F.2d 551. No published California decision recognized the defense until *Opsal v. United Services Auto. Assoc.* (1991) 2 Cal.App.4th 1197 [10 Cal.Rptr.2d 352], and the doctrine was not cited a second time in California for another 8 years, until *Filippo Industries, Inc. v. Sun Ins. Co.* (1999) 74 Cal.App.4th 1429, 1438 [88 Cal.Rptr.2d 881].)

By the time *Filippo Industries* was decided, California courts had been dealing with bad-faith cases for more than 40 years – since *Communale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 658 [328 P.2d 198]. And they had been dealing with first-party bad-faith cases since at least 1973, when the Supreme Court decided *Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566, 574 [108 Cal.Rptr. 480]. How did California courts deal with bad-faith cases in the decades before the genuine-issue doctrine was invented?

Exactly the way they deal with them now. This is because the genuine-issue doctrine is neither a doctrine nor an affirmative defense; it is merely a shorthand way of stating that the plaintiff's bad-faith claim is not sufficient to show that the insurer acted unreasonably when it denied the claim. The Ninth Circuit makes this clear in *Amadeo v. Principal Mut. Life Ins. Co.,* 290 F.3d 1152, 1161 (9th Cir. 2002), explaining:

> The genuine issue rule in the context of bad faith claims allows a district court to grant summary judgment when it is undisputed or indisputable that the basis for the insurer's denial of benefits was reasonable—for example, where even under the plaintiff's version of the facts there is a genuine issue as to the insurer's liability under California law. *Safeco Ins. Co. of Am. v. Guyton,* 692 F.2d 551, 557 (9th Cir. 1982). In such a case, because a bad faith claim can succeed only if the insurer's conduct was unreasonable, the insurer is entitled to judgment as a matter of law.

Seen in this light, the genuine-issue doctrine is neither all that imposing, nor even necessary. Since all it amounts to is a finding that the insurer acted reasonably as a matter of law, there is no case in which the doctrine was properly applied to grant judgment for the insurer that could not have been similarly decided without the use of the doctrine. If the circumstances of the case allow the insurer to show that it acted reasonably as a matter of law, then it wins the bad-faith case, with or without the genuine-issue doctrine.

Why do the courts love it so?

So why have the courts adopted the doctrine with such gusto since 1999? Perhaps as a way to attempt to make bad-faith cases seem less ad-hoc. Rather than forcing the fact-finder to decide what is reasonable on a case-by-case basis, the doctrine appears to reflect an effort to fashion a set of generally-applicable rules that make bad-faith law more predictable. Insurers are told that if they do *x* or *y* or *z*, then they do not have to worry about bad-faith liability, even if their decision is determined, in hindsight, to be incorrect.

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In an attempt to develop broadly-applicable rules the courts have focused more on the *process* that the carriers used to reach a coverage decision, rather than on the decision itself. Carriers are told that if they based their coverage decision on a fair investigation, or upon the advice of unbiased experts, then their decision cannot be characterized as having been made in bad faith.

The problems with this approach are threefold. First, it uses the decision-making process as a proxy for the decision itself, assuming that a reasonable process results in a reasonable decision. In many cases this will be true, but there will always be a temptation for the carrier to attempt to "game" the process to appear unbiased, but to predictably produce the outcome the carrier wants. While a fair process should produce a reasonable outcome, there are simply too many ways for the carrier to manipulate the process to allow the inquiry to be on the process alone. Courts should never lose sight of the fact that the ultimate test of whether a carrier has acted in bad faith is whether its coverage decision was reasonable. (*Pilimai v. Farmers Ins. Exchange Co*. (2006) 39 Cal.4th 133, 147 [45 Cal.Rptr. 3rd 760].)

This leads to the second difficulty in formulating broadly-applicable rules that focus on the decision-making process. The courts' efforts to build in safeguards undermines the utility of the rules. For example, the genuine-dispute doctrine will not apply in the following circumstances: (1) where the insurer was guilty of misrepresenting the nature of investigatory proceedings, (2) if the insurer's employees lie during the depositions, or to the insured, (3) if the insurer selected its experts dishonestly, (4) if the experts were unreasonable, or (5) if the insurer failed to conduct a thorough investigation. (*Guebera*, 237 F.3d at 987; *Chateau Chamberay*, 90 Cal.App.4th at 348-349.)

Bad examples

This is as it should be. But there can be no question that these exceptions provide a fertile field for policyholders' counsel to find factual issues that should preclude summary adjudication, and therefore limit the cases where a court can rely on a generally-applicable rule to resolve a bad-faith case.

The third problem is that efforts to expand the use of the genuine-issue doctrine leads to confusion and untenable outcomes. I can cite two examples. One is the idea that if the policyholder fails to reasonably value his or her claim, this will justify the insurer in similarly making an unreasonable valuation and result in a genuine dispute. The second is the belief that, in all cases, the inquiry into whether the carrier's conduct is reasonable is an objective one, and therefore the carrier's subjective intent has no relevance.

The worst example of the former is the *Rappaport-Scott* case, which arose out of an underinsured-motorist ("UIM") claim. In essence, the court held that the disparity between the amount of damages claimed by the policyholder — $346,000 – and the amount awarded by the arbitrator — $66,000, established that there was a genuine dispute about the amount of damages, as a matter of law. (146 Cal.App.4th at 839.) But in reality the plaintiff had not sought a settlement of $346,000 from her insurer; she had demanded $75,000 (her $100,000 policy limit less a $25,000 credit for settlement with the under-insured driver.)

It is simply illogical to say that because the policyholder was asking for too much that the carrier could offer her only a small fraction of what her claim was actually worth, and that this would be reasonable as a matter of law. The insurer's duty to investigate its policyholder's claim and to fairly evaluate it is independent of the duties the policy imposes upon her. (*Kransco v. American Surplus Lines Ins. Co.* (2000) 24 Cal.4th 390, 402 [100 Cal.Rptr.2d 617].) Hence, even if she had inflated her claim, this would not affect her carrier's obligation to treat her fairly and to properly evaluate her claim.

Objectively wrong

Even more puzzling is the insistence that only the carrier's objective conduct is relevant to the bad-faith inquiry. This school of thought got its start in two cases decided by the same court, the Division Three of the Fourth Appellate District, *Morris v. Paul Revere Life Ins. Co.* (2003) 109 Cal.App.4th 966, 973-974 [135 Cal.Rptr.2d 718]; and *CalFarm Ins. Co. v. Krusiewicz* (2005) 131 Cal.App.4th 273, 287 [31 Cal.Rptr.2d 619].) More recently, it has been adopted by Division Three of the Second Appellate District, in *Delgado.*

In *Morris,* the court rejected the policyholder's claim that it could avoid summary adjudication of its bad-faith claim by arguing that there were "unresolved factual issues pertaining to Revere's subjective understanding of the law and its intent in shaping the law to suit its own ends." (*Id*. at 973.) The court responded by saying: "However, if the conduct of Revere in defending this case was objectively reasonable, its subjective intent is irrelevant." No authority was cited for this particular proposition, but it seems inarguably correct in the context of the facts presented. The same court relied on *Morris* for this proposition when it cited in *Krusiewicz*. (131 Cal.App.4th at 287.)

It is not self-evident why this statement should be true in every case. What if discovery unearthed a note in the claims file stating that the insurer wanted to take a hard line against its insured simply because it wanted to develop a reputation for being tough, even though it subjectively believed that the claim was worth more than it was offering to resolve it? What if the note said that the carrier's employees were angry at the insured for making disparaging public comments and wanted to teach him a lesson? Should the court ignore this evidence of improper motive in denying a claim, because it is "subjective"? Of course not. (*See Bernstein v. Traveler's Ins. Co.* (N.D. Cal. 2006) 447 F.Supp. 1100, 1110 – 1116 [holding that under California law, subjective intent can be relevant in a bad-faith case].)

The focus on "objective" intent to the exclusion of other relevant information can lead a court to absurd results. For example, in *Starr-Gordon v. Massachusetts Mutual Life Ins. Co.* (E.D. Cal. 2006) 2006 WL 3218778, the court held that the purportedly objective nature of the genuine-issue-inquiry required it to grant summary adjudication of the policyholder's bad-faith claim because the insurer's investigation was adequate. But

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on the same record, it was also compelled it to deny the summary-adjudication with respect to the claims for fraud, because the record would support a finding that the carrier deliberately and improperly attempted to terminate her disability benefits with knowledge that she was entitled receive them!

Realizing that this seemed anomalous, the court dropped a footnote, explaining that, "[T]his conclusion would not contradict the court's ruling with respect to the bad faith claim. For example, an insurer may be liable for intentional misrepresentation because it had the subjective intent to defraud the insured but not liable for bad faith because its actions were objectively reasonable. *See Morris*, 109 Cal.App.4th at 973." (*Id*. at *15, n.12.) With respect to the district court, this cannot be right. A carrier who stands to be liable for fraud as a result of the manner in which it handled a policyholder's claim cannot have acted reasonably as matter of law. As the *Bernstein* court explains, "[A]s a general proposition, the covenant of good faith and fair dealing 'has both a subjective and an objective aspect – subjective good faith and objective fair dealing: [a] party violates the covenant of good faith and fair dealing if it subjectively lacks belief in the validity of its act *or* if its conduct is objectively unreasonable." (*Id*. 447 F.Supp. at ___, citing Croskey, Heeseman, et al., *California Practice Guide – Insurance Litigation* (Rutter 2006) Ch. 12 A-C, para: 12:27, citing *Carma Developers (Calif.) Inc. v. Marathon Develop. Calif.* (1992) 2 Cal.4th 342, 376 [6 Cal.Rptr. 2d 467].)

Some good news

Not all the news on the genuine-issue front is bad, however. There are two Ninth Circuit decisions that offer clear guidance to the district courts on the limits of the doctrine: *Hangarter v. Provident Life and Acc. Ins. Co*. (9th Cir. 2004) 373 F.3d 998, 1010, and *Amadeo v. Principal Mut. Life Ins. Co.,* 290 F.3d 1152, 1161 (9th Cir.2002).

In addition, two recent decisions by Division 3 of the Second Appellate district also contain language and analysis that is favorable to policyholders and that should help rein-in overzealous application of the doctrine, *Jordan v. Allstate Ins. Co.* (2007) 148 Cal.App.4th 1062 [56 Cal.Rptr.3rd 312], rev. denied June 27, 2007, and *Delgado v. Interinsurance Exchange*, *supra*.

Jordan is actually *Jordan II*. In *Jordan v. Allstate Ins. Co.* (2004) 116 Cal.App.4th 1206 [11 Cal.Rptr.3d 169] (*Jordan I*), the court held that while the carrier's construction of its policy to deny coverage was *a* reasonable construction, it was not the *only* reasonable construction. Since the policy was ambiguous, the court reversed a summary judgment for the carrier. The carrier then sought to leverage the court's finding that its coverage position was reasonable into a summary adjudication of the bad-faith claim based on the genuine-dispute doctrine. The trial court granted the motion.

The *Jordan II* decision rejected this approach, noting that it ignored the court's finding that there were multiple ways to construe the policy. (148 Cal.App.4th at 1073.) The court explained that the carrier was obligated to fully investigate the policyholder's claim, and could not ignore evidence that supported coverage. (*Id*.) Because the record showed no evidence that the carrier had, in response to the remand in *Jordan I*, taken any steps to investigate the claim based on the coverage theory that supported the claim, the court held that the genuine-dispute doctrine did not apply. (*Id* at 1074-1076.)

Jordan II is enormously helpful to policyholders for three reasons: (1) because it shows how the application of the genuine-dispute doctrine depends on the carrier establishing that it conducted a complete, unbiased investigation; (2) because it made clear that the carrier's duty to investigate continues even after the policyholder files suit (148 Cal.App.4th at 1076, n. 7); and (3) because it explains that a policyholder may properly cite and rely on the carrier's failure to comply with the provisions of the Unfair Insurance Practices Act (Ins. Code § 790.03) and the regulations promulgated under it (10 Cal. Code Regs § 2695.1, et seq.) to provide evidence that the carrier has breached the implied covenant of good faith and fair dealing. (148 Cal.App.4th at 1077-1078.)

With respect to this third point, the court rejected the carrier's assertion that consideration of these statutory and regulatory provisions somehow violated the holding in *Moradi-Shalal v. Fireman's Fund Ins. Co.* (1988) 46 Cal.3rd 287, 305 [250 Cal.Rptr. 116], that these provisions did not grant policyholders a direct private right of action for their violation.

Delgado, although largely favorable to policyholders, is more of a mixed-bag. The claim in that case was made on an Auto Club homeowner's policy after the insured was involved in a fight with a neighbor and then sued. The complaint alleged two claims: that the insured had acted intentionally when he punched the plaintiff and that the insured had negligently believed he was acting in self defense when he punched the plaintiff. The Auto Club inexplicably ignored the potential for coverage inherent in the second claim, and denied all coverage based on the policy's exclusion for intentional acts and on the statutory exclusion for willful acts, Ins. Code section 533. (2007 WL 1810226 at *1.)

After the Auto Club refused to defend him, the policyholder settled with the plaintiff. The parties stipulated in open court that the policyholder had been negligent, and that the plaintiff had sustained injuries of $150,000, and the court entered judgment on the stipulation. The policyholder then paid the plaintiff $25,000 cash and assigned his claims against the Auto Club arising from its refusal to defend or indemnify him, and the plaintiff in return gave a partial satisfaction of judgment and a covenant not to execute on the remainder of the judgment. The plaintiff (Delgado) then sued the Auto Club on the assigned claims and under the direct-action statute, Ins. Code section 11580, subd. (b)(2), as an adjudicated creditor of the insured. (*Id*. at *2.)

The trial court dismissed the bad-faith action on demurrer, and the plaintiff made the case appealable by dismissing his breach-of-contract claims. (Meaning that on remand, the only claim he could assert and recover on was for bad faith.) The appellate court reversed, finding that

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the trial court had no basis to sustain a demurrer to the bad-faith claim.

While many cases explain in clear terms how broad an insurer's duty to defend is, *Delgado* is particularly helpful because it takes that analysis further and explains what the policyholder's options are when the carrier breaches the duty to defend, as well as how those options play out in later litigation against the carrier. The last two sections of the opinion explain why Delgado's complaint stated a cause of action against the Auto Club for bad faith arising out of the breach of its duty to defend. In particular, they explain why the genuine-dispute doctrine did not preclude the bad-faith claim.

Unreasonable, or untenable?

Unfortunately, the court does appear to hold that the genuine-dispute doctrine does apply to third-party claims. More specifically, it holds that if the insurer's refusal to defend is based on a "legal dispute;" that is, one where the coverage issue turns on a legal question and not on the resolution of disputed facts, the genuine-dispute doctrine would probably apply.

Worse, the court speculates (but does not hold) that in such a case, the standard for whether the insurer's position was actionable would be akin to that in a malicious-prosecution action. (2007 WL 1810226 at *12, n. 16.) If the court is suggesting that a carrier may reasonably assert any legal position against its own insured in order to deny coverage, as long as the position would not provide the predicate for a malicious-prosecution claim, it appears to have failed to factor into its analysis the insurer's obligation to give its policyholder's interests equal weight with its own. Surely an insurer who is required to act reasonably and to give equal consideration to its insured's interests when it evaluates coverage should be held to a higher standard than "not tortious."

In *Amadeo* and *Hangarter*, the Ninth Circuit has insisted that the carrier's interpretation of its own policy be reasonable; not simply tenable. For example, in *Amadeo*, the court explained:

> [A]n insurer is not entitled to judgment as a matter of law where, viewing the facts in the light most favorable to the plaintiff, a jury could conclude that the insurer acted unreasonably. [Citation omitted.] . . . . Although summary judgment may be awarded under the genuine issue rule where the insurer reasonably construes ambiguous language in its policy, *see Guebara,* 237 F.3d at 993 (discussing cases), summary judgment is not appropriate when the insurer's interpretation of the policy is sufficiently "arbitrary or unreasonable" that a jury could conclude it was adopted in bad faith. [Citations.] (*Amadeo*, 290 F.3d at 1161-1162.)

Hangartner cites this language with approval. (373 F.3d at 1009 -1010).

With respect to denials that are based on factual disputes, the *Delgado* decision is rock solid. It holds that a carrier who denies a defense based on a factual dispute has effectively committed bad faith as a matter of law:

> As we have shown, a *potential* for coverage *establishes* the duty to defend. Such a potential *necessarily* arises from the existence of a factual dispute as to coverage under the policy. Thus, an insurer faced with a pleading such as the one filed against the insured Reid in this case would have no reasonable basis for concluding that a defense obligation was not owed, at least until it could conclusively negate the possibility of coverage raised by such pleading.

(*Id*., at *12, emphasis in text.)

Delgado was originally published in May 2007, but the opinion was withdrawn after the court granted the Auto Club's petition for rehearing. The new opinion was issued on June 25, 2007, and is largely identical to the original version. The chief difference is the court's response to the carrier's assertion in the rehearing petition that it was justified in concluding that its policyholder had acted intentionally irrespective of the way the complaint was framed. More specifically, the court rejected the Auto Club's claims that even if the policyholder had negligently believed he was acting in self defense, his punches to Delgado's face were delivered intentionally, which negated coverage. The case is therefore also helpful for cases involving coverage for a claim of negligent self defense.

Strategies and pitfalls

Until the Supreme Court says otherwise, if you litigate bad-faith cases you will have to deal with the genuine-dispute doctrine. Know the relevant genuine-dispute cases and take pains to plead and to develop your case in a way that will allow you to raise the factual concerns that they discuss. Most important, keep the focus of the trial court's inquiry on the central issue in any bad-faith case – whether the carrier's conduct was reasonable. If you have done a careful job of evaluating the case before you agree to take it, if you have pleaded the case carefully, and have directed your discovery efforts to the critical pressure points in all genuine-dispute cases, you stand a good chance of convincing the trial court whether the carrier acted reasonably is a factual issue that only the fact finder can resolve.

Pay particular attention to the insurer's investigation of the claim. "Though the existence of a 'genuine dispute' will generally immunize an insurer from liability, a jury's finding that an insurer's investigation of a claim was biased may preclude a finding that the insurer was engaged in a genuine dispute, even if the insurer advances expert opinions concerning its conduct." (*Hangarter,* 373 F.3d at 1010.)

Was the investigation fair and unbiased? Did the insurer take pains to uncover *all* relevant facts, and did it include all of those facts in its analysis? Did the experts the insurer selected have a reason to give the insurer a favorable report? Do they rely on the insurer or the insurance industry for a substantial portion of their income? Has the insurer used them so often that it had reason to know how they would view the issue presented? Has the insurer been scrupulous honest with its policyholder? Has it complied with all of its statutory and regulatory obligations? These are some of the questions you should be asking when you work up a bad-faith case.

And *beware the self-inflicted wound*. If the policyholder has been writing nasty

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letters to the carrier asking for an unrealistic amount of damages and threatening a large punitive-damages award, you may want to pass on signing up the case. Jurors do not like to see policyholders who are looking past their own claim to a big payday in court. Likewise, once the file is in your hands, do not take a position so extreme that a court could conclude that you had created a genuine issue by asking for too much.

Bear in mind that bad faith requires more than proof that the insurer denied a claim, or even that it breached the terms of the policy. Before you file a bad-faith case, something must strike you as unreasonable about the way the carrier acted. Your focus in preparing the case should always be on that unreasonable conduct. If it is there, the genuine-issue doctrine should not be an obstacle between you and the jury.

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