

BAD FAITH LAW IN CALIFORNIA—A THUMBNAIL SKETCH

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BREACH OF THE IMPLIED COVENANT OF GOOD FAITH AND FAIR DEALING

There is an implied covenant of good faith and fair dealing in every contract, requiring that neither party do anything that will injure the right of the other party to receive the benefits of the agreement. *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 684 (1988).

When an insurer unreasonably, or without proper cause, withholds a payment or denies a payment that is due under the policy, the insurer has not only breached the contract, but is subject to the tort of bad faith. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 574-75 (1973); *Waters v. United Services Auto Ass'n*, 41 Cal. App. 4th 1063, 1070 (1996).

The ultimate test is whether the insurance company acted unreasonably. *Opsal v. United Services Auto Assoc.*, 2 Cal. App. 4th 1197, 1205 (1991); *Guebara v. Allstate Ins. Co.*, 237 F. 3d 987, 992 (9th Cir. 2001).

BREACH OF DUTIES

An insurance company has a duty to 1) investigate the pertinent matters thoroughly, impartially, and promptly; 2) to communicate honestly and promptly with the policyholder as the claim is processed; 3) to make timely decisions about the claim; and 4) to explain clearly and forthrightly the bases on which the carrier premised its decision.

Unreasonable conduct can take many different forms. The most common examples are denial of coverage, withholding of benefits, delay in payment of benefits, improper investigation, misrepresenting coverage, refusal to settle claims against the insured, and refusal to provide a defense to the insured. But the list is not exhaustive.

UNREASONABLE DENIAL OF COVERAGE

Not every denial of coverage amounts to bad faith. The denial must be unreasonable. It is possible that the insurance company breached the contract by failing to pay a covered claim, but did not act unreasonably in doing so. In that instance, there is no bad faith. *Tomaselli v. Transamerica Ins. Co.*, 25 Cal. App. 4th 1269, 1280-1281 (1994); *Opsal v. United Services Auto Ass'n*, 2 Cal. App. 4th 1197, 1205 (1991).

Whether an insurance company acted unreasonably normally presents a question of fact for the jury. *Walbrook Ins Co. v. Liberty Mutual Ins. Co.*, 5 Cal. App. 4th 1445, 1454 (1992); *Filippo Industries, Inc. v. Sun Ins. Co.*, 74 Cal. App. 4th 1429, 1438 (1999); *Davy v. Public National Ins. Co.*, 181 Cal. App. 2d 387, 397 (1960). But there are instances in which the court may decide, as a matter of law, that the conduct was either reasonable or unreasonable. See *Chateau Chamberay Homeowners Ass'n v. Associated Intern. Ins. Co.*, 90 Cal. App. 4th 335 (2001)(under so-called "genuine dispute doctrine", there is no bad faith if there was a "legitimate dispute" as to the insurance company's liability); *Century Sur. Co. v. Polisso*, 139 Cal. App. 4th 922, 948-949 (2006)(explaining and limiting the doctrine); *Filippo, supra* at 1438

(doctrine not appropriate where there was no uncertainty in case law about words in policy at issue); *Amadeo v. Principal Mutual Life Ins. Co.*, 290 F.3d 1152 (9th Cir. 2002)(doctrine not appropriate where insurance company's interpretation of disability was arbitrary and pretextual).

At one end of the spectrum, an insurance company acts in bad faith when it knows there is coverage, but denies coverage anyway. *Richardson v. Employers Liability Assurance Co.*, 25 Cal. App. 3d 232, 245 (1972)(punitive damages awarded where insurance company knew that insured had a valid uninsured motorists claim, but nevertheless forced insured to undergo a lengthy arbitration process); *Delgado v. Heritage Life Ins. Co.*, 157 Cal. App. 3d 262, 277 (1994)(actual knowledge that denial of claim is wrongful demonstrates bad faith). At the other end of the spectrum, there may be only modest inferences of bad faith. *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, 78 Cal. App. 4th 847, 909 (2000).

UNREASONABLE DELAY IN PAYMENT OF CLAIM

An insurance company commits bad faith when it fails to act reasonably in processing and handling a claim. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566 (1973). One hallmark of bad faith is unreasonable delay in adjusting a claim. Insurance Code section 790(h); *Fleming v. Safeco Ins. Co.*, 160 Cal. App. 3d 31, 37 (1984); *Palmer v. Financial Indem. Co.*, 215 Cal. App. 2d 419, 429 (1963); *Austero v. National Cas. Co.*, 84 Cal. App. 3d 1, 29-30 (1978); *Bodenhamer v. Superior Court*, 192 Cal. App. 3d 1472, 1476 (insurance company deliberately delayed payment); *Richardson v. Employers' Liability Assurance Co.*, 25 Cal. App. 3d 232, 247 (1972)(nine month delay in paying benefits on a claim carrier knew to be valid constitutes bad faith as a matter of law).

DUTY TO INVESTIGATE

An insurer cannot deny payments to its insured without conducting a thorough investigation. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819 (1979)("[I]t is essential that an insurer fully inquire into the possible bases that might support the insured's claim").

An insurance company has a duty to look for coverage and cannot just look for ways to deny coverage. *Mariscal v. Old Republic Ins. Co.*, 42 Cal. App. 4th 1617 (1996)(insured determined that insured died of illness but ignored other medical records indicating that insured's death was caused by auto accident); *Betts v. Allstate Ins. Co.*, 154 Cal. App. 3d 688, 702 (1984)(insurance company relied on insured's self-serving account of accident and ignored mass of other available evidence indicating insured's negligence); *Downey Savings & Loan Association v. Ohio Cas. Ins. Co.*, 189 Cal. App. 3d 1072 (1987); *Hughes v. Blue Cross of Northern California*, 215 Cal. App. 3d 832, 846 (1989)(insurer made no reasonable effort to obtain all medical records in reviewing medical necessity of hospitalization).

An insurer must affirmatively seek out witnesses who can provide information in support of the insured's claim. *Frommoethelydo v. Fire Ins. Exchange*, 42 Cal. 3d 208, 220

(1996); *Mariscal* at 1624; *McCormick v Sentinel Life Ins. Co.*, 153 Cal. App.3d 1030, 1047-1048 (1984).

The insurer cannot in good faith reject its own experts' advice. *Neal v. Farmers Insurance Exchange*, 21 Cal. 3d 910, 921-23 (1978).

Delgado v. Heritage Life Ins Co., 157 Cal App. 3d 262, 278-279 (1994)(evidence that insurer ignored evidence in file which supported claim, while focusing on facts to deny claim, supported award of \$3 million in punitive damages); *Sprague v. Equifax, Inc.*, 166 Cal. App. 3d 1012, 1025 (1985)(\$ 4 million in punitive damages upheld where claims adjuster testified that he was instructed by supervisor not to find ways to pay claims, but to find ways to deny claims); *Caddice v. Ins. Co. of North America*, 126 Cal. App. 3d 86 (1981)(de facto practice of minimizing payment of claims, as inferred through testimony of claims adjusters and policy manuals); *Tibbs v. Great American Ins. Co.*, 755 F. 2d 1370 (9th Cir. 1985)(bad faith failure to investigate where in-house counsel conducted little investigation and ignored employees who said insured probably entitled to a defense).

The duty to investigate includes the duty to consider legal issues. *Shade Foods, Inc. v. Innovative Product Sales & Marketing, Inc.*, 78 Cal. App. 4th 847, 908 (2000)(bad faith failure to evaluate choice-of-law issues).

DUTY TO DISCLOSE COVERAGE

California Code of Regulations section 2695.4 requires an insurer to disclose all benefits, coverages or other provisions of the insurance policy that may apply to the claim presented. Failure to advise the policyholder of pertinent time limits resulted in waiver to enforce those time limits. *Spray, Gould & Bowers v. Associated International Ins. Co.*, 71 Cal. App. 4th 1260, 1272-73 (1999); *Sarchett v. Blue Shield of California*. 43 Cal. 3d 1, 15 (1987); *Textron Financial Corp. v. National Union*, 118 Cal. App. 4th 1061 (2004)(punitive damages awarded for concealment of coverage); *Hangarter v. Paul Revere Life Ins. Co.*, 236 F. Supp. 2d 1069 (N.D.Cal. 2002), aff'd, 373 F. 3d 998 (9th Cir. 2004)(failure to advise insured of coverage amongst many other bad faith acts); *Ramirez v. U.S.A.A.*, 234 Cal. App. 3d 391 (1991)(duty to disclose possible existence of underinsured motorist coverage).

WRONGFUL REFUSAL TO DEFEND THIRD PARTY CLAIM

Pershing Park Villas v. United Pacific Ins. Co., 219 F. 3d 895 (9th Cir. 2000); *Campbell v. Superior Court*, 44 Cal. App. 4th 1308 (1996); *Shade Foods, supra*; *Century Surety Co v. Polisso*, 139 Cal. App. 4th 922 (2006); *Amato v. Mercury Cas. Co.*, 53 Cal. App. 4th 825 (1997)

DUTY TO SETTLE

The insurance company has a duty to make good faith efforts to negotiate towards a reasonable settlement. *Shade Foods, supra*, at 906-907. An insurance company is required to attempt to settle a claim against the insured when there is a reasonable likelihood of a judgment in excess of the insured's policy limits. *Garner v. American Mutual Liability Co.*, 31 Cal. App. 3d 843, 848 (1973); *Communale v. Traders General Ins. Co.*, 50 Cal. 2d 654, 659-660 (1958); *Crisci v. Security Ins. Co.*, 66 Cal. 2d 425, 429 (1967); *Murphy v. Allstate Ins. Co.*, 17 Cal. 3d 937, 941 (1976).

However, the duty may also be breached when there is an unreasonable denial of a settlement offer below the limits of the policy. *Shade Foods, supra*, at 905-907.

The duty to settle is implied at law, even if the policy does not contain such a provision. *Murphy, supra*.

When the insurer's own counsel advises the insurer to seek settlement rather than gamble on a verdict, the insurer acts in bad faith when it heedlessly gambles on a verdict and loses. *Kinder v. Western Pioneer Ins. Co.*, 231 Cal. App. 2d 894, 901 (1965).

Conditioning settlement upon demand that insured give up other coverage constitutes bad faith. *Shade Foods, Inc. Innovative Product Sales & Marketing, Inc.*, 78 Cal. App. 4th 847 (2000).

UNREASONABLE ("LOW BALL") SETTLEMENT OFFERS

Clayton United Servs. Auto Ass'n, 54 Cal. App. 4th 1158 (1997)(insurance company offered \$10,000 on policy limits of \$300,000 to parents whose only child was killed in automobile accident); *White v. Western Title Ins. Co.*, 40 Cal. 3d 870 (1985)(low settlement offers made in course of bad faith litigation).

UNREASONABLY DEMANDING THAT POLICYHOLDER CONTRIBUTE TO A SETTLEMENT

Coe v. State Farm Mutual Auto Ins. Co., 66 Cal. App. 3d 981 (1977); *Shade Foods, supra* (insurance company offered to pay only a fraction of the covered loss).

UNREASONABLY FILING LAWSUIT AGAINST INSURED

Hillenbrand, Inc v. Ins. Co. of North America, 102 Cal. App. 4th 584 (2002).

ABUSIVE TACTICS

An insurer may not attempt or threaten to rescind the policy where there are no valid grounds for rescission. *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 392 (1970).

An insurer may not attempt to “retire the file without payment” if the insurer, in fact, has no defense to the claim and is simply trying to pressure the claimant into accepting the settlement offer. *Mustachio v. Oho Farmers Ins. Co.*, 44 Cal. App. 3d 358 (1975).

Unsupported allegations that the insured is guilty of insurance fraud constitute evidence of bad faith. *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 575-76 (1973); *Mustachio, supra* at 362 (accusation of arson after basis for charge eliminated by investigator).

Hostile attitude of claims personnel may constitute evidence of bad faith. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 821 (1979)(claims personnel reduced an insured to tears in view of wife and daughter by asserting that insured was a fraud and did not want to return to work).

Adjuster's curt and sarcastic attitude, combined with threats to sue insured, will support a finding of bad faith. *Pistorius v. Prudential Ins. Co.*, 123 Cal. App. 3d 541, 547 (1981).

False promise to provide coverage. *Diamond Woodworks, Inc. v. Argonaut Ins. Co.*, 109 Cal. App. 4th 1020 (2003).

Low settlement offers made during course of bad faith litigation. *White v. Western Title Ins. Co.*, 40 Cal. 3d 870 (1985).

Trickery, fraud, backdating documents, concealing evidence, persisting in denial during course of litigation. *Textron Financial Corp v. National Union*, 118 Cal. App. 4th 1061 (2004).

Unduly restrictive interpretation of disability on questionnaire. *Moore v. American United Life Ins. Co.*, 150 Cal. App. 3d 610, 621 (1984); *Delgado v. Heritage Life Ins. Co.*, 157 Cal. App. 3d 262, 277 (1984); *Miller v. National American Life Ins. Co.*, 54 Cal. App. 3d 331, 339 (1976).

Misleading policyholder about uninsured motorist coverage. *Delos v. Farmers Ins. Group*, 93 Cal. App. 3d 642 (1979).