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EXPERT ANALYSIS

In Insurance Bad-Faith Suits, the 'Genuine Dispute' Doctrine Continues to Thrive

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Since ancient times, lawgivers and jurists have emphasized the need for fairness and reasonableness in the performance of contracts. The Roman jurist Cicero (106-43 B.C.) maintained that contractual relations require the parties to behave with bona fides (good faith), a principle he traced to Rome's first set of written laws dating back to 450 B.C.

Likewise, in modern jurisprudence, we deem every contract to contain an unwritten term called a "covenant of good faith and fair dealing." Under this implied covenant, neither party may do anything to impair the ability of the other to receive the fruits of the contract.

For example, a seller of farmland would likely violate the implied covenant if, immediately after the sale, he diverted a stream on adjoining land so as to deprive the new owner of water the crop requires. The implied covenant "emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party."[1] The violation of the covenant is called "bad faith."

Since the implied covenant is deemed to be an unwritten term of contracts, it makes sense that bad faith generally sounds in contract rather than tort. This means that the prevailing plaintiff can generally obtain contract damages only, rather than tort remedies like punitive or emotional-distress damages. In California, the sole exception applies in the realm of insurance law.

Where an insurance company simply breaches an insurance agreement, it is liable only for ordinary contract damages — usually the amount of benefits at issue under the policy. But where an insurer also breaches the implied covenant, committing what is called "bad faith," it can be liable for tort damages. Tort liability flows in only one direction; although the law also requires a policyholder to comply with the covenant of good faith and fair dealing, only an insurer can be liable in tort.[2]

Insurance stands alone in this regard. Courts will deem bad faith to be a tort (rather than a mere contract breach) only in the context of a wrongful denial of insurance benefits. The California Supreme Court has rejected all attempts to extend the concept of tortious bad faith to other realms of law, such as employment.[3] Courts have explained that this is due to the "special relationship" insurers have with policyholders and their status as "purveyors of a vital service labeled quasi-public in nature."[4] However, it is important not to overstate insurers' special obligations.

For example, the negligent denial of insurance benefits cannot constitute bad faith.[5] Likewise, "[a] n insurer is not a fiduciary, and owes no obligation to consider the interests of its insured above its own."[6] An insurer is not "required to disregard the interests of its shareholders and other policyholders when evaluating claims."[7]

Insurers may be subject to greater exposure than others when it comes to breaches of the implied covenant, but bad faith takes something more than breach of contract, negligence or failure to elevate the insured's interests above those of shareholders.

What distinguishes bad faith from mere breach of an insurance contract is unreasonableness. "The linchpin of a bad faith claim is that the denial of coverage was unreasonable."[8] Whether an insurer's conduct was unreasonable is determined by applying an objective standard. "If the conduct of the insurer in denying coverage was objectively reasonable, its subjective intent is irrelevant."[9] Furthermore, the question is whether the denial was reasonable at the time of denial and not in light of later events.[10]

The contest over bad-faith liability is almost always the central battle of insurance lawsuits. Insurers have long sought to adjudicate bad-faith liability prior to trial by asking the judge to resolve the question on summary judgment. Consequently, the ability to dispose of bad faith on summary judgment (and thus end the possibility of punitive damages, attorney fees, emotional-distress damages and future benefits) is a powerful tool for insurers.

The granting of such a motion usually presages the speedy settlement of the case. In summary judgment proceedings, insurers typically argue that, even if a decision to deny benefits was incorrect as a matter of contract, the court should grant summary judgment and excise the bad-faith count from the action because the decision was not unreasonable.

Thus arises the "genuine dispute" or "genuine issue" doctrine, which "enables an insurer to obtain summary adjudication of a bad-faith cause of action by establishing that its denial of coverage, even if ultimately erroneous and a breach of contract, was due to a genuine dispute with its insured."[11] The California Court of Appeal first announced the doctrine in 2000 and 2001 in *Fraley v. Allstate Insurance Co.*[12] and *Chateau Chamberay Homeowners Association v. Associated International Insurance Co.*,[13] respectively.

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Critically, however, the Court of Appeal did not characterize the doctrine as a new rule. Instead, it said the doctrine was merely an outgrowth of the long-established concept of bad faith. *Chateau Chamberay* defined it as follows: "[W]here there is a *genuine issue* as to the insurer's liability under the policy for the claim asserted by the insured, there can be no bad faith liability imposed on the insurer for advancing its side of that dispute."[14] This rule applies regardless of whether the dispute is over factual or legal issues.

With such a powerful weapon being removed from their arsenal before trial, it is not surprising that attorneys who represent policyholders have been outspoken in their criticism of the genuine-dispute doctrine, and particularly with respect to its use in summary judgment. Plaintiffs' lawyers consistently argue that the genuine-dispute doctrine should be eliminated. The doctrine is a foreign body, they have complained, a barnacle, an unwholesome growth, an outside element grafted onto California bad-faith law. But these are all mischaracterizations. As the cases that named the doctrine made clear, there has never been anything new or foreign about it.

Quite simply, the genuine-dispute doctrine is not a "doctrine" or rule at all, since it is not a separate or distinct principle of law. Rather, it is merely a manifestation of the "[t]he ultimate test of [bad-faith] liability," which "is whether the refusal to pay policy benefits was unreasonable."[15]

Or, as the California Supreme Court has explained, the genuine-dispute doctrine is "a close corollary" to the principle that "an insurer's denial of or delay in paying benefits gives rise to tort damages only if the insured shows the denial or delay was unreasonable."[16]

The genuine-dispute "doctrine," in other words, grows directly out of the definition of bad faith. It is entirely possible to use the doctrine — without ever calling it by that name — simply by invoking the reasonableness principle inherent in bad-faith law. That is what happened in *Morris v. Paul Revere Life Insurance Co.*, where the insurer, in denying the insurance claim, relied on a reasonable interpretation of what was then undecided law. The court ruled on summary judgment that because the insurer's legal position was objectively reasonable (though possibly wrong), it could not be liable for bad faith.

The words "genuine dispute" or "genuine issue" appear nowhere in the ruling. Thus, it is perhaps more appropriate to regard genuine dispute as a shorthand for the principle of reasonableness that is the linchpin of tortious bad faith.

The viability of the genuine-dispute doctrine was finally resolved eight years ago in *Wilson v. 21st Century Insurance Co.*[17] There, the California Supreme Court examined the continuing viability of the genuine-dispute doctrine and whether courts may use it to dispose of bad-faith claims on summary judgment. As is often the case following crucial battles, both sides declared victory. The plaintiffs' bar declared the genuine-dispute doctrine dead. Meanwhile, defense lawyers asserted that *Wilson* had affirmed the doctrine's existence and utility.

Even a cursory reading of *Wilson* sufficiently demonstrates that the genuine-dispute doctrine is alive and well. The case involved an insurer's denial of an insured's request to pay the policy limits on her underinsured-motorist claim. The Supreme Court ruled that summary judgment could not be justified pursuant to the genuine-dispute doctrine under the facts of that case because a jury could potentially rule against the insurer.

However, there can be no doubt that the *Wilson* court affirmed the continued existence of the genuine-dispute doctrine:

> The genuine-issue rule in the context of bad faith claims allows a [trial] 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. ... On the other hand, an 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.[18]

The continued validity of the genuine-dispute doctrine is beyond dispute.

Accordingly, following *Wilson*, trial courts have continued to grant (and courts of appeal have continued to affirm) genuine-dispute summary judgment motions. At least 22 California appeals court rulings (published and non-published) and 43 federal court and 9th Circuit rulings have affirmed or granted summary judgment based on the genuine-dispute doctrine. Eight years later, the consensus is clear: The genuine-dispute doctrine is alive and well.[19]

In sum, the genuine-dispute doctrine, itself simply a manifestation of the reasonableness requirement for good faith, remains a valid method for insurers seeking to resolve bad-faith liability on summary judgment. There can be no doubt it will continue to be for the foreseeable future.

What distinguishes bad faith from mere breach of an insurance contract is unreasonableness.

NOTES

1 Restatement (Second) of Contracts § 205, Comment a. (1981).

2 *Kransco v. Am. Empire Surplus Lines Ins. Co.*, 23 Cal. 4th 390, 402 (2000).

3 *Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 683-699 (1988).

4 *Id.* at 685.

5 *Merritt v. Reserve Ins. Co.*, 34 Cal. App. 3d 858, 880 (Cal. Ct. App., 2d Dist. 1973).

6 *Morris v. Paul Revere Life Ins. Co.*, 109 Cal. App. 4th 966, 973(Cal. Ct. App., 4th Dist. 2003).

7 *Id. See also Nieto v. Blue Shield of Cal. Life & Health Ins. Co.*, 181 Cal. App. 4th 60, 86 (Cal. Ct. App., 2d Dist. 2010) ("Thus, an insurer's bad judgment or negligence is insufficient to establish bad faith; instead, the insurer must engage in a conscious and deliberate act, which unfairly frustrates the agreed common purposes [between the parties] and disappoints the reasonable expectations of the other party thereby depriving that party of the benefits of the agreement.").

8 *McCoy v. Progressive W. Ins. Co.*, 171 Cal. App. 4th 785, 793 (Cal. Ct. App., 2d Dist. 2009); *Major v. W. Home Ins. Co.*, 169 Cal. App. 4th 1197, 1214 (Cal. Ct. App., 4th Dist. 2009) ("The substance of a bad faith action ... is the insurer's unreasonable refusal to pay benefits under the policy.") (citation omitted).

The genuine dispute "doctrine," in other words, grows directly out of the definition of bad faith.

[9] *Bosetti v. U.S. Life Ins. Co. in City of N.Y.,* 175 Cal. App. 4th 1208, 1236 (Cal. Ct. App., 2d Dist. 2009).

[10] *Austero v. Nat'l Cas. Co.,* 84 Cal. App. 3d 1, 32 (Cal. Ct. App., 4th Dist. 1978) ("In evaluating the evidence to see if there was any unreasonable conduct by the company, it is essential that no hindsight test be applied. The reasonable or unreasonable action by the company must be measured as of the time it was confronted with a factual situation to which it was called upon to respond.")

[11] *Bosetti*, 175 Cal. App. 4th at 1237.

[12] *Fraley v. Allstate Ins. Co.,* 81 Cal. App. 4th 1282 (Cal. Ct. App., 4th Dist. 2000).

[13] *Chateau Chamberay Homeowners Ass'n v. Associated Int'l Ins. Co.,* 90 Cal. App. 4th 335 (Cal. Ct. App., 2d Dist. 2001).

[14] *Id.* at 347 (emphasis in original).

[15] *Morris*, 109 Cal. App. 4th at 973-74 (citation omitted).

[16] *Wilson v. 21st Century Ins. Co.,* 42 Cal. 4th 713, 724 (2007).

[17] *Id.*

[18] *Id.* (citation omitted).

[19] *See, e.g., Bosetti,* 175 Cal. App. 4th at 1241 (upholding summary judgment on genuine dispute because "we have found nothing in the voluminous record on appeal which would support a jury's conclusion that the actions and decisions by U.S. Life were unreasonable"); *Heine v. State Farm Mut. Auto. Ins. Co.,* No. A138117, 2015 WL 798158, at *9 (Cal. Ct. App., 1st Dist. Feb. 25, 2015) (unpublished opinion) ("[O]ur Supreme Court, in *Wilson*, confirmed the continuing viability of" the genuine-dispute doctrine); *Myers v. Allstate Indem. Co.,* No. SACV 14-406-JLS DFMX, 2015 WL 3766721, at *4 (C.D. Cal. June 16, 2015) (The "genuine-dispute rule '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.'") (citation omitted); *CV Ice Co. v. Golden Eagle Ins. Co.,* No. CV 14-121 PSG SPX, 2015 WL 72313, at *13 (C.D. Cal. Jan. 6, 2015) (A "single, thorough report by an independent expert is sufficient, all other things being equal, to support application of the 'genuine dispute' doctrine.") (citation omitted); *Erickson v. State Farm Gen. Ins. Co.,* No. 2:12-CV-2784 MCE DAD, 2013 WL 4056280, at *8 (E.D. Cal. Aug. 12, 2013) (granting summary judgment based on genuine-dispute doctrine).

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