BAD FAITH IN CALIFORNIA
RECENT DECISIONS
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I. California Voters Have Rejected Third Party Bad Faith Statutes

On March 7, 2000, voters rejected two referenda that would have confirmed laws enacted in 1999 that had reinstituted third-party bad faith liability for insurers. The margin was approximately 70-30.

II. Supreme Court Decisions and Orders

A. ***Kransco v. American Empire Surplus Lines Ins. Co.*** **(2000) 23 Cal.4th 390, modified by ___Cal.4th___ , 2000 WL 1025625 (July 26, 2000). Insurer may not assert an affirmative defense of comparative bad faith against an insured in a third party bad faith action brought against it for breach of the covenant of good faith and fair dealing.**

In the underlying action, Kransco, a manufacturer of a toy known as Slip 'N Slide, was sued after plaintiff was instantly rendered quadriplegic after an accident on the slide. The case proceeded to trial. During trial, plaintiff offered to settle the action for $750,000, an amount within the primary carrier's limits. Kransco's primary carrier refused to fund this settlement despite the insured's request.

A judgment of roughly $12.5 million, well in excess of the limits, was rendered which included a $10 million punitive damages award. The claim was then settled for $7.5 million after the insured stipulated to entry of judgment with a covenant not to execute. The primary carrier paid its limits, but objected to the settlement on the basis that the verdict would have likely been reduced or reversed on appeal. The excess carriers and the insured also contributed to the $7.5 million settlement.

The insured sued for bad faith. The primary carrier asserted an affirmative defense in response. It argued that the insured had contributed to the $12.5 million verdict because of false interrogatory responses provided by the insured in pretrial discovery of the underlying action. Therefore, it argued, the insured should be liable for comparative bad faith and negligence in the settlement of the suit.

The jury was instructed by the Court to return a special verdict finding of fact on the comparative bad faith and comparative negligence issues. It found that the insured was 90% responsible for the excess verdict. However, on motion by Kransco, the trial court entered judgment not withstanding the verdict for 100% against the insurer.

The Court of Appeal affirmed the trial court judgment in its entirety. The Court held, in part, that in an action against an insurer for bad faith, an insurer does not have an affirmative defense of comparative bad faith or comparative negligence against the insured.

The California Supreme Court on June 22, 2000, affirmed the appellate court decision denying comparative bad faith and negligence as an affirmative defense to an insurer in a third party bad faith action.

In deciding the comparative bad faith issue, the Court noted that the covenant of the insured's duty of good faith and fair dealing, and "the remedies available to the insurer for a breach of that duty,

are fundamentally and conceptually distinct from the insurer's reciprocal duty. . .under the insurance policy." Maj. Opn. at 13. Citing California bad faith case law, the Court noted that "an *insured's* breach of the covenant is not a tort." Maj. Opn. at 13.

The Court distinguished and criticized the case principally relied upon by the insurer, *California Casualty Gen. Ins. Co. v. Superior Court* (1985) 173 Cal. App. 3d 274. The Court in *California Casualty,* did not properly recognize that "it is an *insurer's* breach of the covenant of good faith and fair dealing that is governed by tort principles." Maj. Opn. at 15. The Court disapproved of the *California Casualty* Court's extension of tort principles to an insured's breach of the covenant of good faith and fair dealing. Quoting extensively from and agreeing with the recent decision in *Agricultural Ins. Co. v. Superior Court* (1999) 70 Cal. App. 4th 385, the Court noted that an insured's breach of that covenant is confined by the express contractual provision of the insurance policy and is governed under the law of contract. Thus, the obligations of an insurer and an insured are not comparable.

The Court further assessed the flaws in the insurance company's comparative bad faith defense relating to: (1) whether direct evidence supports an inference that the litigation practices were the proximate cause of the excess verdict; (2) the fact that the compensatory and punitive damage award were based only on the insured's production and sale of the Slip 'N Slide toy; (3) the fact that insurer was made fully aware of the false pretrial discovery practice prior to its rejection of the settlement offer and tendering the self-insured retention in the underlying claim; (4) as a matter of law, the insurer's assertion that the two false interrogatory responses alone begot the punitive damage award; (5) in the Court's view, the insurer's express promise to defend and indemnify and insured, and the implied duty to settle in good faith third party claims, must extend to insureds that are "weak" litigants.

In disposing of the comparative negligence issue, the Court noted that the case relied upon by the insurer, *Patrick v. Maryland Casualty Co.* (1990) 217 Cal. App. 3d 1566, a first party insurance case, "does not shield a third party insurer from full responsibility for its bad faith failure to settle a case even if the insured's litigation misconduct or mishandling of the claim inflated the size of the verdict." Maj. Opn. at 26. Throughout the decision, the Court noted that evidence of misconduct may support contract defenses, cross claims or separate causes of action for breach of the insurance contract.

Concurring with only the result of this case, Chief Justice George dissented from the majority's proposal to reject the comparative bad faith doctrine and disapprove of *California Casualty.*

Writing in vigorous dissent, Judge Kennard noted that the majority denies a jury in bad faith litigation the ability to apportion a policy holder's loss according to the comparative fault of all parties responsible for the loss.

B. *Blue Ridge v. Jacobsen* (November 29, 1999, 9th Cir. 9855052) [1999 WL 1067534] Ninth Circuit Court of Appeal request for certification accepted Jan. 19, 2000, S083934. The California Supreme Court accepted a request for certification from the Ninth Circuit on the question of whether an insurer may recover settlement payments made over insured's objections for claims later found not covered if the insurer gave the insured an opportunity to assume the defense.

The California Supreme Court has accepted the Ninth Circuit Court of Appeals' request for certification on the question of whether an insurer defending under a reservation of rights may recover settlement amounts paid over the insured's objections if the claim is later found not covered under the policy where the insurer gave the insured the opportunity to assume its own defense. Because there was no controlling precedent concerning a question of California state law, the Ninth Circuit Court of

Appeals, pursuant to California Rules of Court Rule 29.5, requested the California Supreme Court to address the issue.

The Ninth Circuit encountered the issue while reviewing an appeal from a ruling from the Central District in California, finding no controlling California precedent, and believing it an important question of insurance law, the court certified the issue for determination by the California Supreme Court.

The facts of the underlying case are as follows. The insureds ran a dog kennel business. They helped plaintiffs Robert and Edee Bolognesi purchase a dog that later attacked Mrs. Bolognesi, causing severe injuries. The plaintiffs sued. The insureds tendered the defense to their homeowner's insurer, Blue Ridge Insurance Company. The insurer disputed coverage on grounds that the claims fell under the "business pursuits" or "professional services" exclusions. The insurer agreed to defend under a reservation of rights and filed a declaratory relief action about the coverage issue. The district court stayed the action until resolution of the underlying action.

Thereafter, the plaintiffs made a settlement offer of the policy limits. The insurer advised the insureds that the settlement offer was reasonable, that the insurer would accept it under reservation to seek full reimbursement, and that the insureds had the option to pick up the defense if they thought the settlement was not reasonable. The insureds did not consent to settlement, believing that the underlying claims were meritless. Subsequent negotiations failed, during which the insureds also refused to waive their right to sue the insurer for bad faith if the judgment exceeded policy limits, and refused to assume their own defense.

The insurer moved to intervene seeking the court's permission to participate in the settlement under a reservation of rights. That motion was denied. Thereafter, the insurer accepted the plaintiffs' policy limit settlement offer over the insureds' objections.

In the declaratory relief action, the court ruled that the policy did not cover the insureds' claims, the settlement offer was reasonable, and that the insurer was entitled to reimbursement of the settlement amount. The court reasoned that: (1) the insurer defended under a reservation of rights; (2) notified the insured of a reasonable settlement offer with the option to take over the defense should the insured choose not to consent; (3) accepted the reasonable offer that was less than the policy limits; and, (4) the court found that there was no coverage under the policy.

On appeal, the Ninth Circuit agreed with the district court that the exclusions precluded coverage and that the offer was reasonable. However, the court lacked guidance on the issue of reimbursement when the insured does not consent to the settlement offer. The most applicable cases were *Johansen v. California State Auto Ass'n. Inter-Ins. Bureau*, (1975) 15 Cal.3d 9 and *Val's Painting & Drywall, Inc. v. Allstate Ins. Co.*, (1975) 53 Cal.App.3d 576, but neither addressed the present issue directly.

Johansen allowed recovery if the insured agreed with settlement under reservation of rights, but did not address what could constitute the agreement or what would happen if there was no agreement. In *Val's Painting*, the court stated that "the insurer is not permitted to seek reimbursement for a particular settlement unless it has secured specific authority to make that settlement or has notified the insured of a reasonable offer by the claimant and given the insured an opportunity to assume the defense." However, the Ninth Circuit was uncertain as to whether the explanation applied to the *Val's Painting* case narrowly (where the reservation of rights letter was inadequate) or stood for the broader proposition that an insured's consent is not required when the insurer provides adequate notice of a reasonable settlement offer coupled with the opportunity to assume their own defense.

This case is still being briefed. Oral argument has not yet been scheduled.

C. *PPG Industries, Inc. v. Transamerica Ins. Co.* (1999) 20 Cal.4th 310. Insured may not shift to its insurance company the payment of punitive damages awarded in a third party lawsuit against the insured as a result of the insured's intentional, morally blameworthy behavior.

A third party brought a personal injury action against the insured, PPG Industries, in Colorado. The underlying plaintiff had been severely injured (he was rendered a quadriplegic) in a car accident and he alleged that his injuries resulted from the egregious misconduct of the insured in improperly installing a car windshield. The insured's primary carrier, Transamerica, agreed to defend the lawsuit, but informed the insured that punitive damages were not covered.

A jury trial resulted in a verdict in PPG's favor, but this verdict was overturned on appeal. Thereafter the insurer turned down the insured's request that it fund a settlement offer from the plaintiff within policy limits. A second jury trial resulted in a verdict against PPG of $5.1 million in compensatory damages and $ 1 million in punitive damages. Transamerica paid its policy limits of $1.5 million toward settlement of the jury verdict. An excess carrier paid $3.6 million to settle the remaining compensatory damages portion of the award.

The insured then sued Transamerica in California alleging that the insurer had breached the covenant of good faith and fair dealing by failing to settle the underlying action. PPG sought recovery of the $ 1 million punitive damages award as compensatory damages alleging that these damages were proximately caused by the insurance company's unreasonable failure to settle the underlying lawsuit. The Court noted that the insurer's alleged "negligent" failure to settle the suit was a cause in fact of the punitive damages awarded against the insured, as was the insured's own intentional egregious misconduct in installing the windshield. The Court, held, however, that the insurer's conduct could not be deemed the proximate cause of the punitive damages award, based on three public policy consideration: (1) the policy of not allowing liability for intentional wrongdoing to be offset or reduced by the "negligence" of another; (2) the purposes of punitive damages are to punish the defendant and deter future misconduct, and (3) public policy prohibits indemnification for punitive damages. Thus, public policy demands that liability for punitive damages must rest with an insured that caused, both in fact and proximately, the damages.

The Court repeatedly referred to the insurer's conduct as "negligent." Thus, it could be argued that if an insurer's bad faith conduct is found to go beyond negligence that this decision is not controlling. Also, we note that this is a 4-3 decision.

D. *Farmers Insurance Exchange v. Jacobs, et al.* (2000) 75 Cal.App.4th 373, opinion decertified Jan. 13, 2000, S083424. The California Supreme Court decertified this opinion holding that an insurer's failure to communicate settlement offers to its insured does not give rise to bad faith where the insurer voluntarily agreed to defend, but, where the policy had expired before the accident.

The California Supreme Court has decertified an opinion of the Second District of the Court of Appeal which held that a bad faith claim is not allowed where an insurer voluntarily undertakes the defense of an accident that occurred after the policy expired, regardless of the quality of the defense provided.

E. *FRI Holdings, Inc. v. Hartford Cas. Ins. Co.* (1999) 70 Cal.App.4th 1023, petition for review withdrawn, opinion decertified June 16, 1999, S077717. The Supreme Court decertified this opinion holding that no bad faith cause of action can be maintained where the insurer was initially granted summary judgment on the duty to defend and that judgment was later reversed.

The California Supreme Court has decertified an opinion of the Fourth District of the Court of Appeal which held that a bad faith cause of action could not be maintained where the insurer was initially granted summary judgment on the duty to defend and that judgment was later reversed. (*See Filippo Industries, Inc. v. Sun Insurance Company* (1999) 74 Cal.App.4th 1429, discussed *infra* holding that a trial court's grant of summary judgment in favor of defendant insurance company does not establish, as a matter of law, the lack of bad faith.)

F. *Kazi v. State Farm Fire & Cas. Co.* (1999) 70 Cal.App.4th 1288, review granted July 21, 1999, S078962. On remand after reversal of the trial court's judgment, insured could state bad faith cause of action against insurer even though trial court found insurer had no duty to defend.

In this lawsuit, the appellate court reached a different result than the *FRI Holdings, supra,* and held that a bad faith claim can be maintained after reversal of a trial court ruling that the insurer had no duty to defend.

This lawsuit arose out of a property line dispute. The Kazis' insurers declined to defend their insureds in litigation between the neighboring property owners. The Kazis sued and included causes of action for breach of contract, bad faith, and negligent claims handling. The latter was dismissed on judgment on the pleadings. One of the insurers counter-claimed for declaratory relief on the duty to defend issue. The matter was ordered to arbitration at which the arbitrator found the insurers had no duty to defend or indemnify. The Kazis requested trial *de novo*. The Los Angeles Superior Court granted the insurers' request to sever and first try the duty to defend issue. At that trial, the court granted a nonsuit after plaintiffs' evidence, ruling there was no duty to defend. Consequently, there was no breach of contract or bad faith.

On appeal, the Second Appellate District (Division Four) concluded, among other things, that there was a duty to defend. Without any discussion of the briefing on this issue or the impact of the trial court's ruling, the appellate court ruled that on remand the insured could pursue claims for bad faith. The appellate court affirmed the ruling dismissing the negligent claim handling cause of action, holding that no separate claim could be maintained since the allegations arose out of duties owed under the insurance contract and were adequately addressed by the bad faith claim.

The California Supreme Court has accepted review of this case on two limited issues: 1) whether interference with an easement right is "property damage" to "tangible property" giving rise to a duty to defend and whether this decision conflicts with *Gunderson v. Fire Ins. Exchg.* (1995) 37 Cal.App.4th 1106; and 2) whether the Court of Appeal incorrectly characterized part of the underlying action as involving physical property damage. Because the court is not reviewing the bad faith issues, the portions of the Court of Appeal decision addressing those issues cannot be cited. Thus, it could be argued that the Supreme Court agrees that a non-suit in the trial court on the duty to defend issue will not preclude an insured from pursuing a bad faith claim if a court of appeal reverses that ruling.

The case has been fully briefed, but it has not yet been set for oral argument.

G. *William Hamilton, et al. v. Maryland Casualty Company,* (2000) 78 Cal.App.4th 640, review granted June 2, 2000, S087346. No claim for breach of the covenant of good faith and fair dealing based on insurer's failure to accept settlement offer by claimants where insurer was providing a defense and claimants and insured entered into settlement without the participation or consent of the insurer.

VLP Enterprises owned a franchise of Great Expectations, a dating service. Maryland Casualty Co. insured VLP. VLP was sued by dissatisfied clients of Great Expectations and Maryland defended VLP against this suit. Without Maryland's approval, VLP entered into a "good faith" settlement with claimants pursuant to which VLP stipulated to the entry of judgment against it and assigned its claims against Maryland to the claimants.

The claimants then filed a direct action against Maryland pursuant to Ins. Code § 11580 and also alleged that VLP was entitled to damages based on Maryland's failure to accept settlement offers from the claimants (made prior to the settlement agreement between the claimants and VLP). Maryland asserted that there had been no breach of its contract with VLP because it had at all times provided VLP with a defense of the suit brought by the claimants.

In reversing the trial court's summary judgment in favor of the claimants, the Court found that the settlement and judgment between claimants and VLP was not binding on Maryland because Maryland had provided VLP with a defense. The Court held that where an insurer provides a defense to its insured and the insured without the participation or consent of the insurer stipulates to a judgment against it the insurer will not be liable and the judgment will not be recoverable in a direct action based on Insurance Code Section 11580.

In addition, the Court addressed whether the claimants could recover as assignees of VLP for Maryland's alleged breach of the covenant of good faith and fair dealing. The alleged bad faith conduct was Maryland's declination of the claimants' settlement offers. The Court noted that where a carrier has agreed to defend its insured, an action for breach of the covenant of good faith and fair dealing based on failure to settle cannot be instituted until a judgment has been entered against the insured that exceeds the insurer's policy limits. Further, the court noted that as long as the insurer is providing a defense, the insurer is allowed to proceed through trial to judgment. The bad faith cause of action becomes operative after the excess judgment has been rendered.

In a footnote, the Court stated: There is authority for the proposition that unreasonable settlement conduct may give rise to a claim against the insurance company on some basis other than exposing the insured to excess liability. The complaint filed by the claimants, however, stated no facts to support such a claim.

Because Maryland had been providing a defense to the insured when VLP settled with the claimants without the participation or consent of the carrier, the court found that VLP had no bad faith claim against Maryland to assign to VLP because no judgment in excess of potential limits had been entered against VLP and VLP had not suffered any other actual injury as a result of any bad faith conduct by Maryland.

III. Bad Faith Cases From The Ninth Circuit Court of Appeals

A. *Pershing Park Villas v. United Pacific Insurance Company,* 9th Cir. (2000) __ F.3d __, 00 C.D.O.S. 5589. Insured May Recover Broad Consequential Damages Resulting from Insurer's Wrongful Failure to Defend

Following jury trial by the United States District Court for the Southern District of California, the Ninth Circuit denied the portion of the judgment holding that third party claimants could recover directly from the insurer without establishing coverage, and for failure to award the insureds the entire amount of the default judgment as consequential damages for the insurer's bad faith failure to defend.

The Pershing Park Villas Homeowners Association ("HOA") sued the condominium developers for construction defects. The developers' insurer agreed to defend. Several months before trial, the insurer withdrew its defense based on outside counsel's opinion that there was no coverage. The insurer did not seek a court declaration at that time. The HOA obtained a default judgment against the developers which the insurer refused to pay. The developers then filed for bankruptcy allegedly as a consequence of the insurer's failure to pay.

In the joint suit by the HOA and developers against the insurer for breach of contract, bad faith and consequential damages, the plaintiffs established through internal documents that the insurer knew of the potential for coverage when it withdrew from the defense. The District Court held that the withdrawal was wrongful as a matter of law.

The insurer's contention that the developers lacked standing to bring a claim belonging to their bankruptcy trustee was denied because the court found that the developers had a sufficient stake constitutionally in the suit. Moreover, the court found that the insurer had essentially waived the issue. The developers obtained compensation for their economic losses and emotional distress and the HOA obtained bad faith damages and was awarded the entire underlying default judgment amount.

On appeal, the Ninth Circuit affirmed the District Court's ruling on the developers' constitutional standing to bring the claim notwithstanding the fact that the claim belonged to the bankruptcy trustee. Further, the court found that the insurer had waived its objections by failing to assert the issue earlier.

With respect to the awards to the HOA, the Court of Appeals held that the District Court erroneously awarded bad faith damages to a non-party to the insurance contract. The insurer owed no duty of good faith to the HOA. The Court of Appeals cited to *Hand v. Farmers Ins*. *Exch.* (1994) 23 Cal.App.4th 1847, for the proposition that a third party generally may not recover from an insurer for bad faith, noting that there can be no bad faith damages where the duty does not exist. (*Hand* has been criticized for allowing a third party judgment creditor to pursue a direct bad faith action against an insurer under limited circumstances.) Accordingly, the HOA, as non-insureds, could not maintain a bad faith action "irrespective of the scope of coverage" and were required to establish coverage for the default judgment under the policy terms before recovery.

The Court of Appeals also held that the developers should have been awarded the amount of the default judgment as consequential damages for the insurer's bad faith refusal to defend, based on *Amato v. Mercury Cas. Co.* (1997) 53 Cal.App.4th 825 and other California precedents.

Under similar reasoning, the Court of Appeals affirmed the developers' emotional distress award. The Court found that their mental suffering stemmed naturally from the insurer's wrongful conduct, and no heightened showing for the independent tort of intentional infliction of emotional

distress was required. Following *Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566 and subsequent cases, the Court held that the insured may recover emotional distress damages if economic damages flow from the initial breach, and bad faith proximately caused mental distress damages.

IV. Bad Faith Cases From The California Courts of Appeal

A. *Ringler Associates Inc. v. Maryland Casualty Co., et al.* (2000) 80 Cal.App.4th 1165, Where Insurer Properly Denies Coverage, Failure to Reserve Rights Promptly Does Not Constitute Waiver

The First District of the Court of Appeal upheld summary judgment granted by the Superior Court of San Francisco County in favor of the insurer holding that the insurer had no duty to defend or indemnify the insured because the policy's first publication exclusion provision barred coverage for defamatory statements made prior to the policy's inception. The court further found that the insurer's defense of the insured and failure to reserve it rights for more than two years did not constitute a waiver.

Ringler Associates Incorporated ("Ringler") obtained an insurance policy from Respondents, Maryland Casualty Company and Northern Insurance Company of New York (collectively referred to as "Respondent"), effective from June 4, 1990 to June 4, 1991. The policy provided coverage for personal and advertising injury, including various forms of commercial defamation, or trade libel and slander. Both policies contained a first publication exclusion, which barred coverage for defamation "arising out of *material whose first publication took place before the beginning of the policy period*" and for "republication of defamatory material whose 'first publication' took place *before* June 4, 1990."

Ringler was one of several defendants in two related underlying cases. The underlying suits alleged that Ringler defamed the plaintiffs. The initial publication of the defamatory remarks occurred in the 1980's, and there was no evidence that any other publication—whether similar to or distinct from the original publication—occurred thereafter, including during the policy period.

Ringler tendered defense of the case to Maryland. After two years of defending Ringler, Maryland reserved its rights and then withdrew its defense based on the policies' first publication exclusions, and the results of its investigation which failed to produce any evidence of defamatory statements made during the policy period.

Ringler sued for bad faith. Both parties filed for summary judgment. The trial court found that there was no duty to defend because the first publication exclusion barred any potential for coverage in the matter.

On appeal, Ringler argued, in relevant part, that Maryland's failure to reserve its rights sooner constituted an admission of coverage and a waiver of Maryland's right to withdraw. The court disagreed explaining that waiver requires the insurer to intentionally relinquish its right to deny coverage. "Thus, an insured's subjective understanding of its insurer's conduct is insufficient to establish waiver, absent some evidence of its actual intent." *Id.* at 1189. Accordingly, the court held that "an insurer does not waive or relinquish any coverage defenses it fails to assert at the time of its acceptance of tender of defense, even when it does not make any express and full reservation of rights for a substantial period of time after the defense has been accepted." *Id*.

The insured further argued that the insurer was estopped from denying coverage. The court again disagreed noting that there was no evidence to support the necessary elements of estoppel,

i.e. (1) the insured's reasonable belief that the insured would provide coverage; and (2) the insured's detrimental reliance on the insured's conduct. There were other insurers defending the insured, thus the Court found the withdrawal did not result in damage to the insured. Moreover, the court found there was no coverage for the claim, and that, as such, the insurer's decision to withdraw was correct.

Finally, the Court stated that an insurer is not required to file a declaratory action prior to its withdrawal from the defense where there is no potential for coverage, although it might be "prudent" to do so.

The opinion is not final. It may be withdrawn from publication, rehearing may be granted, or the California Supreme Court may grant a hearing on it. Should any of these events take place, the opinion would be unavailable for use as authority in other cases.

B. *Old Republic Ins. Co. v. FSR Brokerage, Inc.* (2000) 80 Cal.App.4th 666. Agreement-in-fact test is improper for evaluating whether an insurer properly reserved rights; Insured may not base bad faith claim on insurer's suit against insured without allegations of insurer's unreasonable investigation or payment.

Old Republic Insurance Company ("Old Republic") issued an errors and omissions indemnity policy to Fred Sands Realtors ("FSR"). The policy indemnified the insured ("any partner, officer, director or employee") for losses in excess of the deductible for claims "first made against the Insured during the policy period" and for limited losses arising out of the acts, errors or omissions of independent contractors related to real estate services.

A buyer and seller initiated suits against FSR's agent Cannizzaro and FSR for alleged impropriety in connection with an FSR listed investment property. Thereafter, a law firm sued the agent for failing to pay for services rendered in the buyer's suit. Old Republic paid to settle all three of the above suits.

Agent Cannizzaro subsequently sued Old Republic, FSR and others alleging that he was entitled to coverage and defense costs for the claims against him. Old Republic cross-complained against Cannizzaro and FSR for subrogation, indemnity and declaratory relief. The insurer also alleged that FSR fraudulently concealed Cannizzaro's status as an independent contractor, and submitted false invoices as to defense expenses. FSR responded by cross-complaining against Old Republic for breach of contract and bad faith.

The Court ruled in favor of Old Republic on summary judgment that Cannizzaro was not an insured or a third party beneficiary under the policy because he was an independent contractor. On bench trial, the Court ruled that Old Republic had not adequately reserved its right of reimbursement, which precluded the insurer's other claims with the exception of the false invoices issue. The jury found that Old Republic acted in bad faith, but not with malice, oppression or fraud.

Old Republic appealed on grounds that the trial court erred on 1) finding that the insurer failed to adequately reserve its rights to reimbursement, 2) denying the insurer's right to a jury trial on factual issues of waiver related to the reservation of rights, and 3) denying that the bad faith claim failed as a matter of law.

The appeals court held that the trial court applied the incorrect test for determining whether an insurer made an adequate reservation of rights for reimbursement. The decision of *Buss v. Superior Court* (1997) 16 Cal.4th 35 rejected the agreement-in-fact test asserted by FSR. This test was based on *West v. Haramlambos Beverage Co.* (1987) 195 Cal.App.3d 1308, but *Buss* disapproved of this test.

16 Cal.4th at 52, n.14. It was undisputed that Old Republic initially sent FSR letters properly worded under *Buss*, reserving its right to recoup any indemnity payments.

With respect to the issue of waiver, the appeals court held that it is generally a question of fact. Whether Old Republic waived its right to reimbursement in subsequent communications to FSR was not resolvable as a matter of law. Thus, the Court erred in denying Old Republic's request for jury trial on the issue.

Finally, FSR's bad faith claim failed as a matter of law. An insured may not state a bad faith claim for an insurer initiating litigation against the insured when there are no allegations that the insurer acted unreasonably in investigating or paying a claim. The Court reasoned that no case had addressed the viability of a bad faith claim when the insurer sued its insured after properly paying all policy benefits. Here, FSR's bad faith claim was premised entirely on Old Republic bringing a fraud claim against FSR for concealing Cannizzaro's status as an independent contractor. *White v. Western Title Ins. Co.* (1985) 40 Cal.3d 870; *California Physician's Service v. Superior Court* (1992) 9 Cal.App.4th 1321, 1330, fn 7, and Civil Code section 47 (deeming publications made in any judicial proceeding privileged) preclude a bad faith claim premised solely on an insurer suing after paying all benefits due.

C. *Boicourt v. Amex Assurance Co.* (2000) 78 Cal.App.4th 1390. Insurer's blanket refusal to disclose policy limits may be bad faith conduct because it may foreclose the possibility of a settlement within policy limits. Also, a formal settlement offer is not an absolute prerequisite to a bad faith action.

The underlying claim involved a car accident. The adjuster for Amex Insurance Company ("Amex"), the insurer of the father of the driver of one of the car's involved in the accident, refused as a matter of company policy to disclose applicable policy limits prior to litigation being filed by the injured party. The Court noted the insurer could not disclose the limits without the insured's permission because of a statutory prohibition, but said the insurer should have contacted the insured to ask if he wanted the limits disclosed. The policy limits were $100,000. (An amount which the claimant alleged in the bad faith litigation that he would have settled for prior to being advised that the limits would not be disclosed.) The matter ultimately went to trial and resulted in a stipulated judgment of $2.985 million against the driver and $15,000 against the father, the owner of the car. The driver assigned his rights against the insurance company to the underlying plaintiff in return for agreement not to execute on the judgment. The claimant then filed suit against Amex for bad faith. On appeal, the Court overturned the summary judgment awarded in favor of Amex. The summary judgment was based on the absence of a formal settlement offer, which the trial court found precluded a bad faith claim.

In reversing this result the Court looked to appellate decisions from Florida and Illinois and declined to follow dicta from *Merritt v. Reserve Ins. Co.* (1973) 34 Cal.App.3d 858, 877 wherein the Court opined that bad faith can occur "only" when a formal offer to settle a claim within policy limits is made. The Court found that the *Merritt* court's reasoning on this issue was not persuasive and that the insurer's failure to contact the policyholder to obtain permission to disclose limits created a "conflict situation" with the insurer putting its own interests above the insured's. The harm to the insured that resulted was the loss of a possible settlement opportunity. Thus, the Court held that "a formal settlement offer is not an absolute prerequisite to a bad faith action in the wake of an excess verdict when the claimant makes a request for policy limits and the insurer refuses to contact the policyholder about the request." Id.

In reaching this result, the Court was careful to note that: (1) it was not deciding that Amex had committed bad faith, only that its failure to disclose policy limits prior to litigation without consulting the

insured might qualify as such; (2) its analysis was grounded in the common law of bad faith, rather than any statutory dictates; (3) its decision did not address an insurer's obligation to be proactive in settling cases; and (4) the fact that Amex later tendered policy limits might be a complete defense to the bad faith suit because "a timely settlement offer by a liability insurer does preclude a bad faith action." Id. at 2054.

D. *Shade Foods, Inc. v. Innovative Product Sales & Marketing, Inc. et al.* (2000) 78 Cal.App.4th 847. Insurers' failure to adequately investigate and respond to claims submitted by the insureds and attempt to condition payment of settlement monies on waiver of policy rights constituted bad faith.

Shade Foods, Inc. manufactured cereal nut clusters for General Mills. Innovative Products Sales & Marketing Inc. (IPS) was an almond processor that supplied Shade with processed almonds to be used in the nut clusters. General Mills notified Shade that wood splinters had been found in the nut cluster cereal. It was determined that the IPS processed almonds were the source of the problem. General Mills presented Shade with a claim in excess of $1 million dollars; most of this represented the value of the cereal it had to destroy.

Shade had a commercial general liability policy issued by Royal Insurance Company of America. IPS was insured under a package policy issued by Northbrook National Insurance Company that provided both liability and property coverage. The Northbrook policy also contained a vendor's endorsement naming Shade as an additional insured. IPS and Shade submitted claims relating to the wood contamination to the insurers.

In a letter to IPS, Northbrook denied coverage on the basis that (1) the wood contamination did not constitute "property damage" as defined in the policy; (2) coverage was excluded under the business risk exclusions; (3) claims "arising out of contract" were not covered. This letter did not mention the first-party coverage; and (4) "intentional acts" are excluded.

Northbrook also denied coverage for Shade's claim, again citing the property damage definition and unavailability of coverage for contractual claims as well as exclusions contained in the vendor endorsement. Later, without changing its coverage position, Northbrook entered into negotiations with Shade and made a conditional settlement offer of $1 million which was rejected.

In response to Shade's tender, Royal appointed counsel to represent Shade and issued a coverage opinion that appeared to offer coverage of $1 million. However, three months later, Royal indicated it would only pay 5 to 10 percent of the claim based on its determination that IPS was primarily liable for the contamination. Eventually, fearing it would lose the General Mills account, Shade settled the claim out of pocket with Royal's consent subject to the customary terms of release and assignment.

Shade brought an action for damages against IPS, Northbrook and Royal. IPS cross-complained against Northbrook. IPS tendered defense of the action to Northbrook which was initially denied. However, about a year later, just before trial, Northbrook reconsidered its decision to deny defense and reimbursed IPS for all defense costs incurred to date and to paid for IPS's further legal expenses in the action.

Following trial, a jury reached a verdict that both insurers had committed bad faith. The Court resolved nearly all coverage issues against the insurers. The Court awarded to ISP and Shade against Northbrook nearly $2 million for liability and property compensatory damages, and $5 million in punitive

damages. Against Royal, it awarded to Shade over $1 million in compensatory damages for liability coverage and $8 million in punitive damages.

The Court of Appeal, in a 70-page opinion, affirmed the trial court's conclusions that the property damage was covered and the insurers conduct constituted bad faith. It reversed, however, the award of punitive damages finding that the insurers' conduct did not rise to the level of egregiousness required for an award of punitive damages.

The Court made numerous findings, including the following pertaining to bad faith:

1. Insurer's early closure of investigation and unwillingness to reconsider denial of tender when presented with evidence of factual errors supports finding of bad faith.

2. Insurer's belated offer to pay cost of defense will not cure initial breach of duty to defend.

3. Where claims are made under general liability and property policies, denial of first-party coverage without opening first-party coverage file may be evidence of bad faith.

4. An insurer's general reservation, as part of a letter extending settlement authority, to seek reimbursement from its insured as a condition to settlement may be evidence of bad faith if not circumscribed by a detailed agreement, because the settlement does not achieve finality.

5. Insurer's conditioning of settlement on insured's waiving its right to reimbursement as a third-party beneficiary of first-party coverage is clearly unreasonable and therefore supports a finding of bad faith.

6. An insurer may be liable for bad faith even where rejection of a claim only exposes the insured to liability within policy limits. The Court noted that even where there is no excess judgment, an "...insurer's refusals to settle may be actionable on some other basis."

7. An insurer's answers to interrogatories evidencing the insurer's change of position from declining coverage to providing coverage may support an inference of bad faith.

8. An insurer's contention that an "other insurance" clause limits its indemnity obligations to an insured may support a finding of bad faith.

9. An insurer's concealment of its unwillingness to provide significant coverage until the insured is under urgent business pressure to accept a settlement constitutes bad faith.

10. Evidence of settlement negotiations may be admissible as evidence of insurer's bad faith.

E. *Filippo Industries, Inc. v. Sun Insurance Company* (1999) 74 Cal.App.4th 1429. A trial court's grant of summary judgment in favor of defendant insurance company does not establish, as a matter of law, the lack of bad faith.

Filippo was a distributor of women's' sportswear for D & S Sports-wear. D & S had obtained an open marine cargo policy from Sun Insurance through a Sun underwriter and manager, McGee, which

covered the shipment and storage of imported goods from abroad to the United States. The policy required Filippo to submit monthly reports of the goods' values to assess the premiums. Filippo was routinely late in reporting values and McGee accepted the delayed reports. The obvious happened. A fire took place which resulted in losses exceeding the then current reported values. Filippo then contended that it was owed the full amount despite the late reports.

Filippo filed suit against Sun and McGee for bad faith. Sun and McGee moved for summary judgment claiming that because Sun had paid for all goods that Filippo reported before the fire, no negligence on its part could be shown. The trial court granted the motion. Filippo appealed. The Court of Appeal reversed in an earlier decision, finding that in the absence of any clause specifying the consequences of late filing of inventory reports, coupled with Sun's acquiescence in allowing late reports, Sun was precluded from denying coverage. On remand, the case proceeded to trial. The jury found that both Sun and McGee had breached the contract of good faith and fair dealing and both were liable for punitive damages in differing amounts.

Sun and McGee then filed the instant appeal arguing that the trial court's grant of summary judgment precluded a later finding of bad faith. McGee additionally argued that he could not be found liable for breach of contract or bad faith because those breaches flow from a contract to which he was not a party. The bad faith issue was framed by the Court accordingly: "When an insurer prevails in a motion for summary judgment on its interpretation of the policy coverage but that ruling is reversed on appeal, does the trial court ruling establish, as a matter of law, the lack of bad faith?"

Appellants argued that the trial court's ruling was presumptively reasonable and proved that their interpretation of the policy created a "genuine issue" which in turn precluded a finding of bad faith. The Court, however, disagreed and concluded that "public policy mandates the reasonableness of the insurer's decision must be evaluated as of the time it was made, and that no subsequent court ruling can be the justification for the decision."

The second issue was whether McGee as an agent for a disclosed principal could be found liable as a principal. The Court noted that the causes of action in this case were for breach of contract and bad faith. Both flowed from a contract to which McGee was not a party. Accordingly, the Court held that because Sun was a disclosed principal and subject to liability for its agent's actions and McGee was an agent for Sun, "McGee cannot be held liable for Sun's breach of the contract and concomitant duty of good faith."

F. *Safeco Ins. Co. v. Superior Court (McKinney)* (1999) 71 Cal.App.4th 782. When insurer defends, the insured cannot enter into stipulated judgment without insurer's consent and no bad faith cause of action for refusal to settle can be maintained until the lawsuit has resulted in a verdict in excess of policy limits.

Safeco defended (under reservation of rights) its insured under a homeowner's policy in connection with a wrongful death shooting from a car owned by the insured. The Safeco policy had a specific exclusion that applied to the claim. The insured was also defended by Mercury, the auto insurer. Both insurers provided counsel. Safeco's appointed counsel did not take an active role in the defense.

Prior to trial, the insured stipulated to a judgment in the amount of $645,000, $145,000 of which was to paid by Mercury. The insured assigned all its rights under the Safeco policy. Thereafter, the claimants sued Safeco to recover the $500,000 judgment (Safeco's policy limits) and for bad faith (based upon the assignment). Safeco moved for summary judgment that it had no obligation to pay the stipulated judgment because of the "no action" clause in the policy. Contra Costa County Superior

Court Judge Patsey denied the motion and a writ was taken. The First Appellate District (Division Five) reversed.

The appellate court held that the "no action" clause in the policy precludes an insured from entering into a stipulated judgment when it is being defended by the insurer. The insured has no right to interfere with the insurer's right to control the defense once it agrees to do so and a judgment entered without the insurer's consent is ineffective to impose liability upon the insurer. The rule is different when the insurer refuses to defend. In that event, the insured is free to protect itself, including entering into a stipulated judgment and the insurer will be bound by that judgment (although it can attack the judgment if unreasonable or obtained through fraud or collusion).

Apparently the stipulated judgment was created because Safeco refused to settle. The appellate court noted that an unreasonable refusal to settle is actionable but not until there is a determination that the insured was damaged by the refusal. Thus, where the insurer is providing a defense, it can proceed to trial and if the verdict exceeds policy limits and the insurer's refusal to settle prior to trial is found to have been unreasonable, the insurer will be liable for the fully amount of the verdict. However, the insured's assignment of that cause of action to the claimant prior to trial was premature.

The rationale for the trial court's denial of Safeco's motion was that there was an issue of fact as to whether Safeco was providing the insured with an adequate defense. However, the appellate court noted that until the case concluded, that was an issue that could not be determined. In any event, the defense was also being handled by the other insurer's appointed counsel. The appellate court did not reach the issue of whether the judgment was unenforceable because not covered by the Safeco policy.

G. *Agricultural Ins. Co. v. Superior Court* (1999) 70 Cal.App.4th 385. Insurer cannot sue its insured for tort damages on the basis of "reverse bad faith" but can maintain a cause of action for fraud and punitive damages.

This lawsuit involved a first party claim arising out of property damage allegedly caused by the Northridge earthquake. Agricultural (an excess insurer) paid the first installments of the claim but balked as additional sworn proofs of loss were submitted with ever increasing costs. The insured sued. The action was stayed while Agricultural investigated the claim. The insurer alleged that the insured was uncooperative during this investigation and that it discovered facts substantiating the claim had been misrepresented. For instance, the insured's public adjuster estimated the damages as $2.1 million. This adjuster was fired and then the insured prepared and submitted a preliminary claim for $9 million. After repair work commenced, sworn proofs of loss were submitted totaling in excess of $24.6 million, and the insured claimed the $5 million Agricultural limits. .

The insurer alleged that the earthquake repairs submitted by the insured included unrelated upgrade work to the subject facility and work on two uninsured locations.

The insurer demanded refund of monies paid (approximately $3 million). The insured refused and the insurer filed a cross-complaint, which included causes of action seeking tort damages. The insured demurred to the cross-complaint's causes of action for bad faith (on the basis that no such claim could be pursued by an insurer) and fraud (for lack of specificity) and to the insurer's requests for attorneys fees and punitive damages. The trial court sustained the demurrer without leave to amend on the grounds that the insurer could never state causes of action against its insured for "reverse" bad faith or fraud. The Second Appellate District (Division Two) affirmed the bad faith ruling but reversed and remanded the fraud claim.

Although all parties to a contract have an obligation to act in good faith and deal fairly with each other in performing under the contract, an insurer cannot maintain a tort claim for "reverse" bad faith where that covenant is breached, ruled the Court. This is because the tort remedy was fashioned to address "special factors", e.g., the unequal bargaining power of the parties to the contract. The insured depends upon the insurer for protection and does not have the option if an insurer fails to act properly of going out to the marketplace for other insurance. These same concerns do not apply to the insurer. Thus, the Court found that an insurer cannot seek tort damages where an insured breaches the implied covenant of good faith and fair dealing.

However, an insurer can sue for fraud in the procurement of the insurance contract and in the making of a claim under the contract. The insurer will have to show it acted in reliance on the insured's misrepresentations and, thereby, incurred costs it would not otherwise have incurred. The insurer can also maintain a claim for punitive damages. Because the trial court had not addressed the issue of whether Agricultural's cross-complaint was stated with sufficient particularity, as required for fraud causes of action, the matter was reversed and remanded to the trial court.

The Court, in a footnote, mentioned that the issue of comparative bad faith is currently before the California Supreme Court in the case of *Kransco v. Superior Court* (previously published at 54 Cal.App.4th 1171). It went on to state that even if the Supreme Court finds that "an insurer can assert reverse bad faith as an affirmative defense in a third party situation, such a ruling would not answer the question of whether an insurer can seek an affirmative tort recovery for reverse bad faith in a first party situation."

H. *New Hampshire Ins. Co. v. Ridout Roofing Co., Inc.* (1998) 68 Cal.App.4th 495. The implied covenant of good faith and fair dealing cannot be used to limit an insurer's express rights under the insurance contract.

This coverage lawsuit arose out of the insurer's response to several claims against its insured, a roofing contractor, each of which were tendered to the insurer. Eleven separate and unrelated claims were tendered to the insurer. The insurer sought to recover from its insured the $5,000 per occurrence deductible. The insured refused on the basis that the claims were not covered by the policy. The insurer sued to collect the deductibles. The parties moved for summary judgment. Alameda County Superior Court Judge Kraetzer granted the insurer's motion and denied the insured's motion.

The issue presented on appeal was whether an insurer who, pursuant to the policy has a right to settle claims, may make settlements which "eat up" the insured's deductibles. The First Appellate District (Division Two) affirmed. First the appellate court noted that the implied covenant of good faith and fair dealing cannot be used to limit a party's express rights under a contract. Thus, where the insurer has the right pursuant to the contract to settle claims and then seek reimbursement of the deductible from the insured, that right cannot be limited by the implied covenant of good faith and fair dealing.

Alternatively, even if a cause of action for bad faith could be maintained, the insured suffered no damage from the insurer's conduct. If, as the insured contended, the claims were not covered, then the insured should have paid the entire amount of the claims submitted ($155,340.94) rather than just the amount of the deductibles ($50,000). The insured cannot accept the benefits of the contract (a defense) and then claim that it owes no obligation to reimburse deductibles because no defense was owed.

The Court noted that there then are cases on both sides of the issue across the country and that it might be plausible for an insured to claim that there were limitations of the insurers authority to settle. However, such an argument could not be made here because of the tender.

I. *Mosier v. So. Cal. Physicians Ins. Exch.* (1998) 63 Cal.App.4th 1022. Insurer that voluntarily provides defense to party must act in good faith; however, no damage resulted from breach of that duty.

In defense of a malpractice lawsuit against various parties, the hospital's insurer provided a courtesy defense to the responsible doctor, although not himself an insured. Ostensibly this was because of concerns about the doctor representing himself and the possibility of joint and several liability. The insurer selected counsel to represent the doctor. The attorney worked on a common trial strategy with counsel representing the insured hospital. The appointed attorney provided the doctor with advice including that he should admit liability, and made other tactical decisions during the course of the litigation that may not have been in the doctor's best interests (e.g., not pursuing a theory that other defendants contributed to the damages, not having the doctor testify at trial, not using an expert witness that shifted part of the blame to others). Prior to trial, the doctor filed for bankruptcy protection, a decision in which the appointed attorney concurred. After trial, the jury returned a verdict finding the doctor 70% at fault. Judgment in the amount of $9.8 million was entered against the doctor after offset for settlements and minus the part of the judgment assessed to other defendants.

The doctor sued the insurer. The two causes of action against the insurer that survived for trial were fraud and conspiracy to breach fiduciary duties owed by the attorney appointed by the insurer. The jury found that the doctor's liability should have been 40% rather than 70% and awarded the doctor $4.2 million in compensatory damages, and $65 million in punitive damages which was reduced to $14 million following a motion for new trial.

On appeal from the Los Angeles County Superior Court (Judge Munoz), the Second Appellate District (Division Four) reversed the judgment. First the Court held that an insurer that voluntarily provides a defense creates a relationship that gives rise to a duty to exercise care in performing those duties, just as it would if it had insured the doctor. The situation presented was, according to the Court, analogous to the conflict situation addressed by *Cumis*. (*San Diego Federal Credit Union v. Cumis Ins. Society, Inc.* (1984) 162 Cal.App.3d 358; Civil Code § 2860.) Because a conflict of interest existed between the insurer and the one it agreed to defend, the doctor should have been given the opportunity to select his own counsel.

The appellate court found that there was sufficient evidence for the jury to have found fraud against the insurer and that the insurer conspired to breach a fiduciary duty owed to the doctor because of the insurer's agreement to defend. However, the Court concluded that the doctor had failed to prove any fraud or breach of fiduciary duty caused him damage. Although the second jury apportioned damages differently in the retrial of the malpractice action, that could be explained by the different, newer evidence that was allowed to be introduced over the insurer's objection. There were other differences in the two proceedings, including that the second jury learned that the doctor filed for bankruptcy because of the earlier verdict. Although there was evidence in the record to support the different allocation, the Court found that the difference was not attributable to the fault of the insurer or defense counsel retained to represent the doctor.

On the doctor's bankruptcy, the evidence was that the doctor had considered bankruptcy prior to the insurer assuming his defense. There was no suggestion that, if instead of 70%, the original verdict had been 40%, the doctor could have avoided bankruptcy. Thus, the different outcome of the medical malpractice trial did not damage the doctor.

J. *Joe Anguiano v. Allstate Ins. Co.*(9th Cir. 2000) 209 F.3d 1167. When Third-Party Claim Exposes Insured to Liability in Excess of Policy Limits, Insurer Must Notify Its Insured of Offer to Settle Claim within Policy Limits Before Claimant Sues Insured

The Ninth Circuit Court of Appeal reversed a decision of the District Court for the Central District of California which granted Allstate's motion for summary judgment based on its finding that there was a question of fact as to whether Allstate committed bad faith by failing to communicate to its insured a third-party claimant's settlement offers.

Anguiano, a minor, was seriously injured in a car accident as a passenger in a car driven by Romero. Romero was found to be 100% at fault for the accident. Romero was insured by Allstate. Policy limits were $15, 000 per passenger, $30,000 per accident, with an additional $1,000 in medical payments coverage. Allstate, recognizing that Romero was potentially exposed to damages in excess of the policy limits because of the severity of Anguiano's injuries, offered Anguiano's mother $16,000 to settle the claim. She did not accept. Allstate never communicated these settlement negotiations to Romero.

The mother later contacted Allstate to accept the offer, but Allstate added additional terms relating to the structuring of the settlement to account for Anguiano's status as a minor. The mother did not accept these additional terms, but offered to settle for $16,000 in cash. Allstate rejected this counteroffer, and again did not communicate the negotiations to its insured. The mother hired an attorney who again offered to settle for $16,000 if the check was received in five days. Allstate failed to timely respond and once again did not communicate the offer to its insured.

Anguiano sued in state court. A stipulated judgment was entered against Romero for $8 million. The stipulation assigned Romero's claims against Allstate to Anguiano. Anguiano filed a bad faith action against Allstate in state court which was removed to federal court. Allstate moved for summary judgment which was granted by the district court. The Ninth Circuit Court of Appeal reversed. It found that a genuine issue of material fact existed as to whether Allstate properly handled Anguiano's settlement offers.

The Court noted that insurers have an obligation to communicate settlement offers to their insureds. It further noted that that the duty to communicate settlement offers is particularly important when there is a conflict of interest between the insurer and insured. The Court found that a conflict of interest arose when Anguiano made an offer to settle within policy limits because Allstate was aware that Romero was exposed to liability beyond the limits.

Allstate contended it had no duty to communicate Anguiano's offers because they were defective in that they did not take into account a disputed MediCal lien. The Court of Appeal, however, found that such a defect did not relieve an insurer of its obligation to forward settlement offers to the insured.