The "genuine dispute" defense: Overused and abused

Like the boy who cried "wolf," insurers will cry "genuine dispute" to try to limit their liability

By David M. Lilienstein and Travis M. Corby

Reasonableness lies at the heart of every bad-faith insurance case. Was the insurer's investigation thorough and its decision-making process reasonable? Did it make a fair settlement offer? Even if the insurer ultimately paid a given claim but delayed making a decision, were the delays reasonable?

If the answer to any of the above is "no," then the insurer may have breached the covenant of good faith and faith dealing. Otherwise put, it acted in bad faith. In California, since bad faith is a tort, a finding of bad faith can open the insurer to liability, inter alia, for the resulting emotional and financial distress. Attorneys' fees can also be awarded.[1] Sufficiently egregious bad-faith conduct also opens the door to an exemplary damages award.[2]

Insurers, on the other hand, attempt to avoid scrutiny of their faulty investigations and bad-faith denials by relying on what has become known as the "genuine dispute doctrine."

Under this doctrine:

> [t]he mistaken [or erroneous] withholding of policy benefits, if reasonable or if based on a legitimate dispute as to the insurer's liability under California law, does not expose the insurer to bad faith liability. . . . Without more, such a denial of benefits is merely a breach of contract.[3]

Insurers must have viewed the *Chateau Chamberay* decision as a godsend, because they now cry "genuine dispute" with the same knee-jerk consistency that they deny legitimate claims. The numbers speak for themselves: Shepardize the *Chateau Chamberay* opinion and find 803 total citations, more than 200 of which are California and Ninth Circuit published and unpublished decisions. Check back next week and odds are there will be one or two new additions to the list.

Fortunately, many courts do not view the genuine dispute issue as the insurers' panacea. No matter what the stage of a case – demurrer, summary judgment, or trial – there is ample case law to maintain a bad-faith action against a genuine dispute defense. Unfortunately, as discussed below, it might require the involvement of the courts of appeal.

Demurrer

In *Brehm v. 2st Century Ins. Co.*,[4] the insurer demurred to a bad-faith cause of action on the basis of a genuine dispute. *Brehm* involved a claim under an Underinsured Motorist (UIM) policy. The insured was rear-ended while stopped at a red light, and provided medical evidence of serious injury. He settled with the third-party driver's insurance carrier for policy limits and filed a claim with his insurer, 21st Century. He demanded $85,000, plus medical expenses. 21st Century offered $5,000, based on its expert's conclusion that the insured simply suffered from a soft tissue injury.

In anticipation of arbitration, the insured, Mr. Brehm, arranged for an Independent Medical Examination. The ensuing report provided further evidence of serious injuries related to the car accident. Mr. Brehm then increased his demand slightly, to the policy limits – $90,000 – plus medical expenses. 21st Century offered the same $5,000, plus an additional $5,000 in medical expenses. The case went to arbitration, where the insured received an award of $91,186.

In his complaint, Mr. Brehm alleged that 21st Century failed to make a good-faith settlement offer, despite clear liability. 21st Century demurred to the bad-faith cause of action. Relying on its medical expert, the company claimed that this was a "classic 'genuine dispute.'"[5] The trial court bought this argument and sustained 21st Century's demurrer without leave to amend.

The plaintiff prevailed on appeal. The court held that the reasonableness of 21st Century's settlement offer could not be adjudicated at the pleading stage. It noted that the genuine dispute rule "does not relieve an insurer from its obligation to thoroughly and fairly investigate, process and evaluate the insured's claim. A *genuine* dispute exists only where the insurer's position is maintained in good faith and on reasonable grounds."[6] This means that an insurer cannot eschew its responsibility to treat its insured fairly

and in an unbiased manner; for example by using experts to provide a pretext for a claim denial.[7]

The court in *Brehm* provided further guidance on properly pleading bias by an insurer's medical expert. It noted the plaintiff's allegations that 21st Century's chosen physician was biased and that his examination was a sham, meant solely to provide the company with a pretext for denying (or undersettling) his claim, and concluded that they were sufficient to the insurer's genuine dispute defense – at least at the pleading stage.[8]

Finally, the court rejected 21st Century's contention that its $5,000 offer of settlement was reasonable as a matter of law, despite the ultimate arbitration award, stating that:

> The reasonableness of 21st Century's settlement counteroffer at the time it was made is simply not a question that can be resolved at the pleading stage . . . .The question whether the insurer has acted unreasonably in responding to a settlement offer is a question of fact to be determined by the jury.[9]

Although not every case involves a UIM policy, *Brehm* provides substantial guidance on defeating the genuine-dispute-based demurrer.

Summary judgment

Most commonly, practitioners will face the genuine dispute doctrine at the summary judgment stage. Therefore, keep in mind that finding evidence to support the existence of a genuine dispute will be at the heart of the insurer's discovery plan. Also keep in mind that in order for an insurer to obtain summary judgment based on a genuine dispute, the record must be sufficient to allow the trial court to find that no reasonable jury could accept the view of the plaintiff or the plaintiff's experts.

Or hope that your insurer/defendant is 21st Century. *Brehm, supra,* can be seen as a follow-up to a prior decision involving this insurer, *Wilson v. 21st Century Ins. Co*.[10] *Wilson* effectively put the genuine dispute doctrine to rest with its focus on the reasonableness of the insurer's conduct, and not on whether the insurer could point out disparate facts to cobble together a pretext for a claim denial.

Wilson also involved a UIM policy. The plaintiff was hurt in an automobile accident, and two months later still complained of neck, shoulder and wrist pain. She sought medical attention, and was given x-rays and an MRI examination. Her treating doctor concluded that the injuries were accident-related.

Without ever speaking to the treating physician or seeking other medical analyses, 21st Century again characterized the injury as "soft tissue" and again offered a $5,000 settlement. Further, it sought to offset the $5,000 by the payout from the third-party policy, resulting in a net payment to its injured insured of $0.

As a separate basis for denying the claim, the 21st Century examiner decided the insured could not be seriously injured because she was able to vacation in Australia.

As in *Brehm*, *supra*, the insured in *Wilson* also demanded arbitration of the claim denial. At a pre-arbitration deposition, evidence arose that an orthopedic surgeon had recommended spinal fusion surgery for Ms. Wilson. Then – and only then – did 21st Century seek an independent medical examination. When that exam came back positive, a new claims examiner at 21st Century reversed the company's denial and offered the full UIM policy limits. In the interim, more than two years had gone by.

Plaintiff sued for bad faith, based solely on the two-year delay in approving her claim. 21st Century contended the initial denial was reasonable on the basis of a genuine dispute. The trial court agreed, granting the company summary judgment on the bad-faith claim.

On appeal, the appellate court reversed the trial court's decision, which was later affirmed by the California Supreme Court. California's high court made it clear that *Chateau Chamberay* and the genuine dispute doctrine do not insulate the insurer from performing a proper, fair investigation, and from its duty to treat insureds reasonably and in good faith.[11] The court went on to state that summary judgment is only proper when "it is indisputable that the insurer's denial of benefits was reasonable. . ."[12]

Perhaps the court was also perturbed by 21st Century's claim that injured people can't travel, because it felt the need to state that:

> [a]s to the fact that Wilson was studying in Australia (not on vacation, as the claims examiner baselessly asserted) in 2001, the Court of Appeal aptly observed that "it is as possible to suffer 'severe pain' in Australia as in Southern California."[13]

Indeed, the court believed that a jury could find that 21st Century used the Australia trip as "a pretext or rationalization" for denying the claim.[14]

Jury instructions at trial

At trial, expect the insurer to make one last attempt at genuine dispute misdirection. And expect to defeat this attempt. In *McCoy v. Progressive West Ins. Co*.,[15] involving the denial of an auto theft claim, the plaintiff not only won on insurance bad faith, but also secured a punitive damages verdict.

The plaintiff in McCoy was a seven-year veteran of the United States Navy. He owned a Ford Mustang. He made his car payments on time. The theft occurred during a trip to Las Vegas; the car was later found burned and damaged, and of virtually no value.

Progressive concluded that, although Las Vegas is "one of the car theft capitals in the United States," and that "Mustangs were frequently stolen," the theft was suspicious.[16] It noted that there was no "trauma" to the ignition, but did not reach a conclusion as to whether the Mustang was stolen with a tow truck or a duplicate key.[17] It relied on the statement of Mr. McCoy's ex-wife, who contacted Progressive of her own volition, stating

that her former husband had wanted to get rid of his car. Progressive did not examine this individual under oath and she later recanted her statement.

It took Progressive almost one year to deny Mr. McCoy's claim. However, Progressive almost immediately reported him for fraud to the California Department of Insurance (DOI) and to other law enforcement or regulatory agencies, before its own investigation was complete, in violation of the company's own internal guidelines. The DOI later responded that there was "insufficient evidence to support a criminal investigation."[18]

Needless to say, the jury was not pleased with Progressive's conduct. It unanimously found that Progressive acted in bad faith. It further found that Progressive had acted with malice and oppression, warranting a punitive damages award.

At trial the parties agreed on two CACI jury instructions: (1) CACI 2331, which read in pertinent part that the plaintiff "must prove all of the following: … Progressive … unreasonably failed to pay policy benefits …"[19]; and (2) CACI 2332, which also read in pertinent part that the plaintiff "must prove all of the following: … Progressive … unreasonably failed to properly investigate the loss and denied coverage/failed to pay insurance benefits..."[20]

That was not enough for Progressive, which proposed two additional instructions, based on *Chateau Chamberay*, *supra*. This first, and shorter, proposed instruction was:

> When an insurer denies or delays payment of policy benefits due to the existence of a genuine dispute with its insured as to the existence of coverage liability, the insurance company will not be liable in bad faith even though it may be liable for breach of contract.[21]

The second proposed instruction was:

> In determining whether or not an insurance company had a genuine dispute as to whether or not a loss was covered, you may consider among the following: (1) Whether the insurance company was guilty of misrepresenting the nature of the investigation; (2) Whether the insurance company adjusters and investigators lied during their depositions or to the insured; (3) Whether the insurance company dishonestly selected its experts; (4) Whether the insurance company experts were unreasonable; and, (5) Whether the insurance company failed to conduct a thorough investigation.[22]

The trial court refused to give the jury both of Progressive's requested instructions. On appeal, Progressive contended that this was prejudicial error.

The court held that there was no need to give the additional two jury instructions. Noting that the heart of a bad-faith action is the reasonableness of the insurer's conduct, it concluded that Progressive's proposed instructions were unnecessary, stating that "the trial court properly instructed the jury on the issue of reasonableness pursuant to CACI Nos. 2331 and 2332. Both parties agreed that these instructions be given. No further instruction in this regard was necessary."[23] Thus, CACI 2331 and 2332 subsume the genuine dispute premise.

Indeed, after *McCoy*, it would be legal error for a trial court to agree to give a separate genuine dispute doctrine jury instruction.


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Endnotes

[1] See *Brandt v. Superior Court* (1985) 37 Cal.3d 813.
[2] See Code. Civ. Proc., § 3294
[3] *Chateau Chamberay Homeowners Association v. Associated International Ins. Co*. (2001) 90 Cal.App.4th 335, 346-347
[4] (2008) 166 Cal.App.4th 1225
[5] *Brehm*, 166 Cal.App.4th at p. 1233 (quoting *Chateau Chamberay*, *supra*, 90 Cal.App.4th at p. 347)
[6] *Id*. at p. 1238 (emphasis in original) (internal citations and quotations omitted)
[7] *Id*. at p. 1239 (internal citations and quotations omitted)
[8] See *id*. at pp. 1240-1241
[9] *Id*. at pp. 1240-1241 (internal citations and quotations omitted)
[10] (2007) 42 Cal.4th 713
[11] *Wilson*, 42 Cal.4th at 723 (citing *Chateau Chamberay*, *supra*, 90 Cal.App.4th at pp. 348-349
[12] *Id*. at p. 724
[13] *Id*. at p. 722
[14] *Id*. at p. 725
[15] (2009) 171 Cal.App.4th 785
[16] *McCoy*, 171 Cal.App.4th at p. 79
[17] See *ibid*.
[18] *Id*. at p. 789
[19] *Id*. at p. 794, fn. 3
[20] *Ibid.*
[21] *Id*. at p. 792, fn. 2
[22] *Ibid.*
[23] *Id*. at p. 794