Civil No. G036896
Superior Court Case No. 00CC04293

In the Court of Appeal, State of California

FOURTH APPELLATE DISTRICT

DIVISION THREE

GRIFFIN DEWATERING CORPORATION,
Plaintiff and Respondent,

vs.

NORTHERN INSURANCE COMPANY OF NEW YORK,
Defendant and Appellant.

APPLICATION OF UNITED POLICYHOLDERS FOR LEAVE TO FILE A BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF UNITED POLICYHOLDERS IN SUPPORT OF GRIFFIN DEWATERING CORPORATION

Appeal from the Superior Court of the State of California
for the County of Orange

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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FOURTH APPELLATE DISTRICT, DIVISION THREE

Case Name: **GRIFFIN DEWATERING V. NORTHERN INS. CO.** Court of Appeal No: **G036896**

CERTIFICATE OF INTERESTED ENTITIES OR PERSONS
(Cal. Rules of Court, rules 8.208, 8.490(i), 8.494(c), 8.496(c) & 8.498(d))

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The undersigned certifies that the above listed persons or entities (corporations, partnerships, firms or any other association, but not including government entities or their agencies), have either (i) an ownership interest of 10 percent of more in the party if an entity; or (ii) a financial or other interest in the outcome of the proceeding that the justices should consider in determining whether to disqualify themselves, as defined in rule 8.208(d)(2).

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Party Represented

United Policyholders
(Name)

July 19, 2007
(Date)

Civil No. G036896
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In the Court of Appeal, State of California

FOURTH APPELLATE DISTRICT

DIVISION THREE

GRIFFIN DEWATERING CORPORATION,
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vs.

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APPLICATION OF UNITED POLICYHOLDERS FOR LEAVE TO FILE A BRIEF AMICUS CURIAE

Appeal from the Superior Court of the State of California
for the County of Orange

TO THE HONORABLE JUSTICES OF DIVISION THREE OF THE FOURTH APPELLATE DISTRICT:

United Policyholders ("UP") respectfully requests leave to file the attached brief amicus curiae in this appeal, and in support of this application shows:

1. UP is a not-for-profit corporation (tax-exempt under Internal Revenue Code section 501(c)(3)) founded in 1991 to educate the public, the judiciary, and elected officials on insurance issues and the rights of insureds. Funded by donations and grants from individuals, businesses, and foundations, UP is based in Northern California and operates across the United States. Among other things, UP monitors legal developments that impact insureds and publishes materials aimed at educating insureds and insurers alike. UP has previously appeared as amicus curiae in over 220 cases in the California courts. The organization recently accepted an invitation from this division to submit an amicus brief in *Hailey v. California Physicians' Service*, Case No. G035579. UP has also appeared as amicus curiae in cases before the United States Supreme Court and was the only national consumer organization to submit an *amicus* brief in the landmark case of *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408 (2003).

2. This case concerns the proper application of two significant insurance coverage doctrines—the "genuine dispute doctrine" and *Brandt* fees. As such, it involves issues of statewide importance to insureds. Indeed, these doctrines potentially concern every insurance coverage case involving a bad faith claim. This appeal presents an opportunity to clarify when, if ever, the genuine dispute doctrine may be used to cut off a bad faith claim in the context of the duty to defend. It also presents an opportunity to clarify when *Brandt* fees may be recovered from a breaching insurer that continues to reserve rights and contest coverage, unreasonably forcing its insured to litigate through trial.

3. UP is familiar with the appellate briefing in this case. In its briefing, UP raises arguments and considers relevant case law not discussed by the parties. In particular, UP addresses the history of the genuine dispute doctrine and *Brandt* fees and discusses the doctrines in the context of related insurance coverage issues in an effort to provide the Court with a useful context in assessing the applicability of these doctrines to this case. In so doing, UP provides the Court with a unique perspective that should be helpful in resolving these two issues on appeal.

4. Additionally, the attached brief amicus curiae does not address all of the arguments of either party. As such, the brief brings a unique perspective to this case. Accordingly, UP respectfully seeks leave to file the attached brief so that, in resolving this matter, the Court will have the benefit of the perspectives presented in the brief, as well as of the arguments and precedents not heretofore presented.

WHEREFORE, UP respectfully requests leave to file the attached brief amicus curiae.

DATED: July 19, 2007

DICKSTEIN SHAPIRO LLP

By: _____

KIRK A. PASICH
CASSANDRA S. FRANKLIN
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Attorneys for United Policyholders

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BRIEF AMICUS CURIAE OF UNITED POLICYHOLDERS

IN SUPPORT OF GRIFFIN DEWATERING CORPORATION

TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

PAGE

Cases

Statutes

Other Authorities

I. INTRODUCTION

This brief amicus curiae is directed to two of the issues before the Court in this appeal: (1) Whether the genuine dispute doctrine should preclude a determination that an insurer acted in bad faith when the insurer denied its insured a defense without fully investigating the insured's claim, failing to accord its insured's interests at least as much consideration as its own; and (2) Whether an insured may recover the full amount of attorneys' fees incurred to obtain the benefits due under the policy, even though the insurer paid the benefits sometime before trial, when the insurer continues to assert throughout trial that it should recover the benefits because it had no duty to pay. As shown below, the answer to question (1) is "no;" the answer to question (2) is "yes."

The genuine dispute doctrine applies in limited circumstances where it can be determined as a matter of law that an insurer's denial of coverage or benefits was reasonable. The doctrine originated in the Ninth Circuit and initially was applied only in the first-party context. California courts of appeal eventually adopted and developed the doctrine. However, the California Supreme Court has yet to embrace the doctrine. The appellate courts have infrequently applied the doctrine in the context of third-party coverage. And, only a couple of very recent California appellate cases have addressed its viability in the context of the duty to defend and none has embraced it in that context. However, the doctrine clearly should have no bearing when (as appears to be so in this case) the insurer denies coverage based on a mere pretext developed in a one-sided and superficial investigation of its insured's claim.

When an insurer is determined to have acted in bad faith, *Brandt* fees should be awarded in full insofar as they have been incurred to obtain the benefits due under the policy. This is so even after the insurer pays its insured if the insurer continues to assert that there is no coverage after a conditional payment and forces the insured to

litigate the coverage issue to lay it to rest. Otherwise, insurers will routinely force their insureds to litigate claims that they should reasonably have paid without further contest.

II. THE HISTORY AND DEVELOPMENT OF THE GENUINE DISPUTE DOCTRINE

Under California law, a covenant of good faith and fair dealing is implied in all insurance contracts and requires the insurer to accord its insured's interests at least as much consideration as it gives its own interests. *Frommoethelydo v. Fire Ins. Exch.*, 42 Cal. 3d 208, 214-15 (1986) (insurer's failure to investigate insured's claim fully constituted breach of covenant of good faith and fair dealing); *Egan v. Mut. of Omaha Ins. Co.*, 24 Cal. 3d 809, 818-19 (1979) (insurer's denial of disability benefits without thorough investigation constituted breach of covenant of good faith and fair dealing); *Crisci v. Sec. Ins. Co.*, 66 Cal. 2d 425, 429 (1967) (refusal to settle when would be most reasonable manner of resolving claim breaches covenant of good faith and fair dealing). "Good faith performance . . . of a contract emphasizes faithfulness to an agreed common purpose and consistency with the [reasonably] justified expectations of the other party." *Neal v. Farmers Ins. Exch.*, 21 Cal. 3d 910, 921 n.5 (1978). When an insurer breaches the covenant of good faith and fair dealing, the insurer is said to act in "bad faith." *Jordan v. Allstate Ins. Co.*, 148 Cal. App. 4th 1062, 1078 (2007).

The covenant of good faith and fair dealing has special significance in the insurance context because insurers "are 'invested with a discretionary power affecting the rights of another,' and the insurance business is 'affected with a public interest and offers services of a quasi-public nature.'" *Amadeo v. Principal Mut. Life Ins. Co.*, 290 F.3d 1152, 1161 (9th Cir. 2002) (citations omitted). *See also Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 684-85 (1988) (explaining policy reasons for tort liability for breach of covenant of good faith and fair dealing given the "special relationship" between insurer and insured); *Frommoethelydo*, 42 Cal. 3d at 215 (insurer required to

act with "qualities of decency and humanity inherent in the responsibilities of a fiduciary").

In connection with liability insurance, "[a]n insurer 'must defend a suit which *potentially* seeks damages within the coverage of the policy." *Delgado v. Interinsurance Exch. of the Auto. Club of S. California*, 152 Cal. App. 4th 671, 681 (2007). *See also Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc.*, 78 Cal. App. 4th 1308, 847, 881 (2000) (breach of implied covenant may be premised on insurer's breach of duty to defend); *Campbell. v. Superior Court*, 44 Cal. App. 4th 1308, 1319 (1996) ("[I]f an insurer *unreasonably* fails to defend, it has breached the implied covenant of good faith and fair dealing.").

The covenant of good faith and fair dealing "has both a subjective and an objective aspect—subjective good faith and objective fair dealing." H. Walter Croskey &. Rex Heeseman, *California Practice Guide: Insurance Litigation* § 12:27 (2006) [hereafter "*Insurance Litigation*"]. *See also Carma Developers (California), Inc. v. Marathon Dev. California, Inc.*, 2 Cal. 4th 342, 372 (1992) ("A party violates the covenant if it subjectively lacks belief in the validity of its act or if its conduct is objectively unreasonable".)[1] Thus, while the honest mistake or negligence of an insurer does not rise to the level of bad faith, *Chateau Chamberay Homeowners Ass'n*

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[1] Certain courts have stated the contrary in passing. *E.g.*, *Delgado*, 152 Cal. App. 4th at 680; *Morris v. Paul Revere Life Ins. Co.*, 109 Cal. App. 4th 966, 973 (2003). However, as discussed more fully below, this cannot be so in the context of a biased investigation, such as when the insurer's ultimate stance may be objectively reasonable, but its initial denial of the insured's claim sought only to defeat the claim, holding its own interest above that of the insured. Such a standard would undermine the covenant of good faith and fair dealing by allowing an insurer to act without consideration of its insured's interests and suffer no consequences if the insurer could later justify its conduct as objectively reasonable. Furthermore, it would undermine the duty to investigate by encouraging an insurer to grasp at the first possible straw that might objectively allow it to deny coverage and abandon its investigation before thoroughly exploring all possibilities for coverage—a result decidedly contrary to the duty to investigate, as discussed more thoroughly below.

v. Assoc. Int'l Ins. Co., 90 Cal. App. 4th 335, 346 (2001), an insurer "violates the covenant *if it subjectively lacks belief in the validity of its act* or if its conduct is objectively unreasonable." *Insurance Litigation* § 12:27.

Thus, whether an insurer has acted in bad faith is "ordinarily a question of fact to be determined by a jury by considering the evidence of motive, intent and state of mind." *Chateau*, 90 Cal. App. 4th at 350. *See also Dalrymple v. United Servs. Auto. Ass'n*, 40 Cal. App. 4th 497, 511 (1995). However, in certain limited cases, where it is indisputable that the basis for an insurer's denial of benefits was reasonable, courts have adjudicated the insured's bad faith claim as a matter of law, applying what has come to be known as the "genuine dispute" (or "genuine issue") doctrine in the Ninth Circuit and California. *E.g.*, *Amadeo*, 290 F.3d at 1161.[2] Because it is so draconian, dismissal of a bad faith claim as a matter of law has been called "the insurer's lethal weapon." Douglas G. Houser, Ronald J. Clark, & Linda M. Bolduan, *Good Faith as a Matter of Law—An Update on the Insurance Company's "Right to Be Wrong,"* 39 Tort Trial & Ins. Prac. L.J. 1045, 1060-61 (2004). Accordingly, as discussed more fully below, the doctrine should not be applied in a case such as this where the insurer has not raised a genuine and legitimate basis for dispute or conducted a thorough and unbiased investigation.

The doctrine was first announced in a Ninth Circuit case concerning first party coverage[3] and a question of law regarding the interpretation of the policy. *Safeco Ins.*

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[2] Other jurisdictions have adopted a similar doctrine, commonly known as the "fairly debatable" doctrine. *E.g.*, *Marathon Ashland Pipe Line LLC v. Maryland Cas. Co.*, 243 F.3d 1232, 1247 (10th Cir. 2001) (Wyoming law; refusal to defend not "fairly debatable" when insurer does not comply with statutory obligations and fails to properly investigate claim); *Acceptance Ins. Co. v. Brown*, 832 So. 2d 117 (Ala. 2001) (insurer's biased investigation defeated claim that refusal to defend was "fairly debatable"); *Thompson v. U.S. Fid. & Guar. Co.*, 559 N.W.2d 288, 292 (Iowa 1997) (wrongful termination of workers' payments not bad faith where claim "fairly debatable" as matter of law, based on potential intoxication defense).

[3] First-party insurance is designed to protect the insured and its property for losses directly incurred by the insured. Kirk A. Pasich, *Casualty & Liability Insurance* 1-1

Co. of Am. v. Guyton, 692 F.2d 551 (9th Cir. 1982). *Safeco* involved a then-unsettled legal issue regarding the proper causation standard under the first party provisions of a homeowner's policy. The insureds in *Safeco* had suffered severe property damage during a hurricane that flooded their property. The insurer denied coverage on the ground that the flood was excluded, regardless of whether it was caused by a covered cause and filed an action for declaratory relief. The trial court agreed and dismissed the insureds' counterclaims for breach of contract and bad faith. Although the Ninth Circuit reversed the dismissal of the breach of contract claim, the court affirmed the district court's dismissal of the bad faith claim. *Id.* at 557. The court reasoned that, although the insurer's coverage position turned out to be incorrect, "the policy in dispute involved a genuine issue concerning legal liability, [and therefore the insurer] could not, as a matter of law, have been acting in bad faith by refusing to pay on the [insureds'] claims." *Id.*

Other federal courts followed, deciding bad faith claims as a matter of law where the existence of a genuine dispute regarding coverage was so clear that a jury could not reasonably decide the bad faith claim against the insurer. *E.g.*, *Franceschi v. Am. Motorists Ins. Co.*, 852 F.2d 1217, 1220 (9th Cir. 1988) (no bad faith where genuinely arguable issue regarding term in health insurance policy). Some courts extended the doctrine to factual disputes. *E.g.*, *Feldman v. Allstate Ins. Co.*, 322 F.3d 660 (9th Cir. 2003) (conflicting taped statements regarding value of stolen items created genuine issue regarding whether insured purposely inflated value of items); *Guebara v. Allstate Ins. Co.*, 237 F.3d 987, 994 (9th Cir. 2001) (thorough

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(LexisNexis Business Law Monographs 2003). It includes, for example, property insurance, health, life, and disability insurance, business interruption insurance. *See id.* By contrast, third-party insurance, also known as liability insurance, provides coverage for claims by third parties against the insured. *Id.* "In essence, an insurance carrier typically agrees to defend and indemnify the insured against such claims." *Id.* Such insurance includes, for example, commercial general liability policies like the one at issue in this case, as well as errors and omissions and directors' and officers' insurance. *See id.*

investigation by independent experts established genuine dispute regarding possibility of arson, which was excluded under homeowners policy).

It was almost ten years after *Safeco* when the first California state court of appeal applied the genuine dispute doctrine. *See Opsal v. United Servs. Auto. Ass'n*, 2 Cal. App. 4th 1197 (1991). Like *Safeco*, *Opsal* concerned a homeowner's policy and the coverage dispute centered on an unresolved question of law regarding the meaning of the policy. The insured discovered cracking in the foundation of a residence and claimed property damage under the insurer's policy. A soils engineering firm asserted that this damage was the result of settlement caused by improperly compacted fill soils and inadequate footing depth. The insurer asserted that its "earth movement" exclusion applied and there was no coverage. The court disagreed and concluded that the exclusion only applied to naturally occurring movement. *Id.* at 1203. Nonetheless, the court pointed out that, at the time of the insurer's denial, there was a genuine issue as to the proper interpretation of the exclusion. *Id.* at 1205-06. Accordingly, the coverage denial could not reasonably be viewed as without proper cause and the case could be decided as a matter of law. *Id.*

Other California state court of appeal decisions followed. *E.g.*, *Morris v. Paul Revere Life Ins. Co.*, 109 Cal. App. 4th 966, 976-77 (2003) (genuine dispute doctrine applied to disability insurer's reliance on reasonable policy interpretation, supported by decisions in other cases, regarding meaning of manifestation); *Chateau*, 90 Cal. App. 4th 335 (when insurer's thorough investigation raised legitimate factual issues regarding coverage, genuine dispute doctrine applied to insured's claim under homeowners policy).

To this day, many cases applying the genuine dispute doctrine concern an unsettled question of law arising in the context of first-party insurance coverage. *Century Sur. Co. v. Polisso*, 139 Cal. App. 4th 922, 951 (2006) ("The doctrine has been applied primarily in first-party coverage cases, usually involving disputes over

policy language or its application."). *See, e.g.*, *Morris*, 109 Cal. App. 4th 966; *Opsal*, 2 Cal. App. 4th 1197; *Franceschi*, 852 F.2d 1217 (genuine dispute regarding proper interpretation of "medical treatment" in health insurance policy); *Safeco*, 692 F.2d 551 (genuine dispute regarding proper causation standard to apply under California law). *But see Amadeo*, 290 F.3d 1152 (9th Cir. 2002) (no genuine dispute regarding insurer's unreasonable interpretation of policy to include "unemployment" as regular occupation).

A number of courts have also applied the doctrine to cases involving factual disputes in the first-party coverage context. *E.g.*, *Rappaport-Scott v. Interins. Exch. of the Auto. Club*, 146 Cal. App. 4th 831 (2007) (genuine factual dispute regarding claim for damage caused by uninsured motorist); *Chateau*, 90 Cal. App. 4th 335 (genuine factual dispute regarding earthquake damage claimed under homeowners policy); *Fraley v. Allstate Ins. Co.*, 81 Cal. App. 4th 1282 (2000) (disparity in scope and value of repairs under homeowners policy established genuine dispute); *Nager v. Allstate Ins. Co.*, 83 Cal. App. 4th 284 (2000) (genuine dispute over amount of payment due for medical expenses under auto policy); *Feldman*, 322 F.3d 660 (reliable evidence that insured may have inflated value of claimed loss created reasonable basis for dispute); *Guebara*, 237 F.3d 987 (factual information developed during investigation demonstrated reason to suspect fire intentionally set, barring coverage under homeowners policy). *But see Jordan,* 148 Cal. App. 4th 1062 (2007) (no genuine dispute where insurer failed properly to investigate); *Filippo Indus., Inc. v. Sun Ins. Co. of New York*, 74 Cal. App. 4th 1429 (1999) (no genuine dispute where insurer did not properly investigate)

A handful of courts have considered the doctrine in cases involving third-party liability coverage. *E.g.*, *Calfarm Ins. Co. v. Krusiewicz*, 131 Cal. App. 4th 273 (2005) (when promissory estoppel was basis for insurer's duty to pay arbitrator's award, insurer's refusal to pay was genuine issue because based on reasonable policy

interpretation not clearly resolved by existing cases); *Dalrymple*, 40 Cal. App. 4th 497 (insurer reasonably delayed paying benefits and pursued declaratory relief action when lawyer investigated law and facts and determined that insured's shooting and injury of member of SWAT team could reasonably have been viewed as intentional under existing case law); *Am. Cas. Co. of Reading, Pennsylvania v. Krieger*, 181 F.3d 1113 (9th Cir. 1999) (insured failed to introduce evidence that insurer acted unreasonably in interpreting policy to exclude rehearsal of bungee-jumping event when exclusion barred coverage for rehearsing or practicing any sport or athletic event); *Clemco Indus. v. Commercial Union Ins. Co.*, 665 F. Supp. 816 (N.D. Cal. 1987) (genuine dispute existed regarding trigger of CGL coverage based on unsettled issue when insurer investigated law and, based on its own independent evaluation and that of counsel, took position reasonably supported by case law), *aff'd*, 848 F.2d 1242 (9th Cir. 1988).

A few Ninth Circuit cases have stretched the doctrine to include the duty to defend with little analysis. *E.g. Lunsford v. Am. Guar. & Liab. Ins. Co.*, 18 F.3d 653 (9th Cir. 1994) (genuine dispute doctrine precluded bad faith claim when insurer properly investigated insured's claim; *SEMX Corp. v. Fed. Ins. Co.*, 398 F. Supp. 2d 1103 (S.D. Cal. 2005) (genuine dispute based on insurer's reliance on legal precedent from out of state reasonable when no California authority existed to excuse duty to defend).

No California case has applied the genuine dispute doctrine to bar a bad faith claim in a duty to defend a case. *See, e.g.*, *Polisso*, 139 Cal. App. 4th 922 (no genuine dispute regarding duty to defend when complaint and extrinsic evidence gave rise to potential for coverage); *Delgado*, 152 Cal. App. 4th 671 (2007) (no genuine dispute regarding duty to defend when factual issues created potential for coverage).

The California Supreme Court has not yet addressed the viability or proper scope of the genuine dispute doctrine.[4] However, as noted above, the supreme court has emphasized the special place of the covenant of good faith and fair dealing in connection with insurance policies. *See, e.g., Foley*, 47 Cal.3d at 684-85. Thus, courts and commentators have pointed out the danger that overzealous application of the doctrine may compromise the special importance of the covenant of good faith and fair dealing in the context of insurance law.

For example, this month, the Honorable Rex Heeseman suggested that the California Supreme Court may limit the doctrine to first-party cases concerning legitimate disputes regarding an unsettled area of coverage law or jettison the doctrine entirely. Hon. Rex Heeseman, *Genuine Dispute*, L.A. Daily J., July 13, 2007. (A copy of this article printed from the Los Angeles Daily Journal's website is attached as an appendix for the Court's convenience.)

Ninth Circuit Judge Betty Fletcher noted in a particularly well-reasoned dissent that the genuine dispute doctrine is "of uncertain provenance," having been developed primarily in the Ninth Circuit, rather than in the state courts to which the Ninth Circuit should look when sitting in diversity. *Guebara*, 237 F.3d at 999 & n.4 (9th Cir. 2001). Judge Fletcher went on to question whether the California Supreme Court would adopt the rule, even when restricted to coverage disputes arising out of questions of law. *Id.* at n. 4.

The court of appeal in *Polisso*, 139 Cal. App. 4th 922, questioned whether the doctrine should be applied to the duty to defend at all. *Id.* at 950-51. *Accord*

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[4] A case involving the interplay between the genuine dispute doctrine and the duty to investigate in the context of uninsured motorist coverage is currently pending before the California Supreme Court and it seems likely that the court will address at least some aspects of the doctrine. *See Wilson v. 21st Century Ins. Co.*, 136 Cal. App. 4th 97 (2006), *review granted*, 43 Cal. Rptr. 3d 749 (April 26, 2006) (No. S141790) (court of appeal concluded failure to evaluate medical records or conduct independent medical examination constituted inadequate investigation of uninsured motorist claim and precluded application of the genuine dispute doctrine).

Delgado, 152 Cal. App. 4th at 691-93 (finding it "not entirely clear . . . to what extent that the 'genuine dispute' doctrine will apply in *third* party cases, such as the one before us," and ultimately concluding that doctrine should not apply to refusal to defend in face of factual disputes establishing potential for coverage).

And, in *Bernstein v. Travelers Insurance Co.*, 447 F. Supp. 2d 1100 (N.D. Cal. 2006), in a particularly scholarly exploration of the genuine dispute doctrine, Magistrate Judge Wayne Brazil cautioned that

> there are limits to the applicability of the genuine dispute doctrine—and [the] courts should take care not to extend the use of that doctrine so far that it obliterates across the board the fundamental precept that the requirement of "good faith and fair dealing" imposes both a subjective and an objective duty. In other words, despite (or maybe even especially in view of) the creep of the genuine dispute doctrine, California courts should not forget that "an insurer's bad faith is ordinarily a question of fact to be determined by the jury by considering the evidence of motive, intent and state of mind."

Id. at 1114 (citing *Chateau*, 90 Cal. App. 4th at 350).

Perhaps for this reason, more recently, courts have been reluctant to apply the doctrine except in the clearest of cases. *E.g., Polisso*, 139 Cal. App. 4th at 952 (finding "no legitimate dispute" where insurer conducted biased investigation); *Jordan*, 148 Cal. App. 4th at 1074 (insurer's abandonment of investigation of claim based solely on one possibly reasonable interpretation of exclusion did not establish genuine dispute sufficient to insulate insurer from bad faith liability); *Delgado*, 152 Cal. App. 4th at 689-93 (no genuine dispute regarding duty to defend when factual dispute established potential for coverage; allegation of denial of defense in such circumstances was sufficient to state a cause of action for bad faith refusal to defend).

With this history in mind, we explain below why the doctrine has no application where an insurer has not conducted a thorough, unbiased investigation of the insured's claim and the sole "genuine issue" concerns a pretextual issue.

III. THE DUTY TO DEFEND IS A CRITICAL ASPECT OF THE PROTECTION AN INSURED EXPECTS WHEN PURCHASING LIABILITY COVERAGE

In a seminal decision regarding the duty to defend, the California Supreme Court stated:

> The insured's desire to secure the right to call on the insurer's superior resources for the defense of third party claims is, in all likelihood, typically as significant a motive for the purchase of insurance as is the wish to obtain indemnity for possible liability. California courts have been consistently solicitous of insureds' expectations on this score.

Montrose Chem. Corp. v. Superior Court, 6 Cal. 4th 287, 295-96 (1993). Accordingly, when "a liability insurer owes a broad duty to defend its insured against claims that create a potential for indemnity . . . . [T]he carrier must defend a suit which *potentially* seeks damages within the coverage of the policy." *Montrose*, 6 Cal. 4th at 295. Indeed, the duty exists not only when the likelihood of coverage is clear; but when coverage is dubious and may never develop. *Id.*

> If any facts stated or fairly inferable in the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer's duty to defend arises and is not extinguished until the insurer negates all facts suggesting potential coverage.

Scottsdale Ins. Co. v. MV Transp., 36 Cal. 4th 643, 655 (2005). Accordingly, if any allegation in a complaint potentially is covered, an insurer must defend the entire action. *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1084 (1993) (allegations in complaint gave rise to duty to defend entire action even though other allegations in complaint clearly were not covered). "'Facts extrinsic to the complaint give rise to a duty to defend when they reveal a possibility that the claim may be covered by the policy.'" *Delgado*, 152 Cal. App. 4th at 680. "In other words, the duty to defend arises whenever the lawsuit against the insured seeks damages on *any theory* that, if proved, would be covered by the policy." *Id.* at 681.

Given the fundamental importance of the duty to defend,, the *Delgado* court found that a potential for coverage "*necessarily* arises from the existence of a factual dispute as to coverage under the policy." *Delgado*, 152 Cal. App. 4th at 692-93. Thus, while the court could not find bad faith as a matter of law on the basis of pleadings without proof, the court strongly indicated that the genuine dispute doctrine would not apply when a factual dispute existed. *Id.* at 692-93. Rather, a potential for coverage, and hence a duty to defend, "*necessarily* arises from the existence of a factual dispute as to coverage under the policy." *Id.* at 692-93. By definition, then, when there is a "genuine dispute" regarding coverage, there is at least a possibility that coverage will be found. Where the facts of a case establish this potential, even if it is far from certain, the duty to defend is triggered.

Appellant Northern concedes that the genuine dispute doctrine should not apply to factual disputes establishing a potential for coverage. (Appellant's Opening Brief ("O.B.") at 25 ("The law requires insurers to defend when there is a potential that the underlying facts could be resolved in a way that would create coverage.").) Nonetheless, Northern insists that the doctrine should apply here because the dispute regarding coverage turned on a genuinely disputed question of law. (*Id.* at 25-26.)

Delgado indicated that the genuine dispute doctrine might apply to duty to defend cases when there existed a legal dispute, so long as the insurer's legal position regarding the coverage issue is objectively reasonable and legitimate. *Delgado*, 152 Cal. App. 4th at 692 & n.16. However, *Delgado* did not have before it a disputed legal issue and this statement was dicta. And, as discussed more fully below, *Polisso* and other decisions teach that courts should be particularly careful not to eliminate bad faith claims in circumstances where insurers have failed to conduct a reasonable investigation of both the facts and the applicable law.

Indeed, contrary to Northern's protestations, and explained more fully below, the genuine dispute doctrine should not automatically immunize an insurer from bad

faith liability when there is a vacuum in the law. It should not, for example, bar a bad faith claim when the insurer has ignored factual information (especially evidence, as in this case, from its own underwriters) indicating that the policy should be interpreted to provide coverage. Nor should it protect an insurer that (as Northern did in this case) turns a blind eye to case law favoring its insured. It certainly should not protect an insurer that refuses to change its position when binding case law answers the coverage question in favor of the insured (again, as Northern ignored *MacKinnon v. Truck Insurance Exchange*, 31 Cal. 4th 635, 652-53 (2003) (no evidence that pollution exclusion directed at ordinary acts of negligence; rather, exclusion intended to apply only to traditional environmental pollution) and continued to assert that the pollution exclusion precluded coverage for the sewage back-up that was the subject of underlying lawsuit). At a minimum, the doctrine should not apply when, as appears to be the case here, the insurer seizes on the first available pretext to avoid coverage and abandons its duty to investigate before conducting a full and thorough assessment of the facts and law pointing toward coverage. Otherwise, insurers will simply be encouraged to assert pretextual legal grounds for avoiding coverage—disregarding their insureds' interests in violation of the covenant of good faith and fair dealing. Cf. *Egan*, 24 Cal.3d at 819.

IV. THE GENUINE DISPUTE DOCTRINE SHOULD NOT APPLY WHEN THE INSURER CONDUCTED A BIASED AND INCOMPLETE INVESTIGATION AND DENIED ITS INSURED A DEFENSE ON THE BASIS OF A PRETEXTUAL ISSUE

As part of the covenant of good faith and fair dealing, "an insurer cannot reasonably and in good faith deny payments to its insured without thoroughly investigating the foundation for its denial." *Egan*, 24 Cal. 3d at 819. Thus, to protect the interests of its insured, "it is essential that an insurer *fully* inquire into possible bases that might support the insured's [position]." *Id.* Indeed, the

> implied promise requires each contracting party to refrain from doing anything to injure the right of the other to receive the

> agreement's benefits. To fulfill its implied obligation, an insurer must give at least as much consideration to the interests of the insured as it gives to its own interests. . . . [A]n insurer cannot reasonably and in good faith deny payments to its insured without fully investigating the grounds for its denial.

Frommoethelydo, 42 Cal. 3d at 214-15.

This duty is at the core of the insurer's covenant of good faith and fair dealing with its insured. *Shade*, 78 Cal. App. 4th at 879 ("Among the most critical factors bearing on the insurer's good faith is the adequacy of its investigation of the claim."). For this reason, an insured's bad faith claim should not be barred as a matter of law, notwithstanding the presence of a "genuine dispute," when the "insurer failed to conduct a thorough investigation." *Chateau*, 90 Cal. App. 4th at 348 (2001) (insurer conducted thorough investigation of homeowner's earthquake claim; therefore genuine dispute regarding coverage precluded bad faith claim). *See also Jordan*, 148 Cal. App. 4th at 1074 (failure to conduct thorough investigation may provide basis for bad faith claim even where insurer's interpretation of policy language reasonable); *Shade*, 78 Cal. App. 4th at 880, 888 (insurer's early closure of investigation and adoption of inflexible refusal to consider obligations to insured without thorough exploration of grounds for coverage supported finding of bad faith). "[A] carrier can be found liable on a bad faith theory for conducting an investigation that is unjustifiably superficial or perfunctory *or that looks only in one self-serving direction*." *Bernstein*, 447 F. Supp. 2d at 1112.

Accordingly, the genuine dispute doctrine cannot insulate the insurer from a bad faith claim when the insurer's denial of the duty to defend was based on a superficial or biased investigation. *E.g.*, *Jordan*, 148 Ca. App. 4th at 1076 & n.7 (evidence that insurer failed to thoroughly investigate all bases of coverage for insured's collapse claim under homeowner's policy precluded application of genuine dispute doctrine; duty to investigate continued after coverage lawsuit was filed); *Polisso*, 139 Cal. App. 4th at 950 (genuine dispute doctrine not available to insurer

that ignored allegations and extrinsic evidence potentially establishing coverage); *Chateau*, 90 Cal. App. 4th at 348-49 (where insurer denies coverage without conducting a reasonable investigation, the insurer's failure to investigate breaches its implied covenant); *Hangarter v. Provident Life & Accident Ins. Co.*, 373 F.3d 998, 1010-11 (9th Cir. 2004) (genuine dispute doctrine did not apply because substantial evidence presented at trial supported jury's determination that insurer engaged in biased investigation of facts and law); *Guebara*, 237 F.3d at 996 (genuine dispute doctrine does not insulate insurer that conducted biased investigation); *Back v. Allstate Ins. Co.*, No. CIV. S-04-5, 2005 U.S. Dist. LEXIS 34676 at *30 (E.D. Cal. July 13, 2005) (refusing to grant summary judgment when jury might reasonably find insurer's misrepresentation of law and facts establishes bad faith)[5]; *Hubka v. Paul Revere Life Ins. Co.*, 215 F. Supp. 2d 1089, 1094 (S. D. Cal. 2002) (genuine dispute doctrine not available when insurer cut short investigation and denied coverage based on medical reviewer's examination of paperwork without knowledge of insured's profession and without conducting actual medical examination of insured).

This is especially so when, as appears here, the insurer only belatedly asserts the doctrine as a last ditch attempt to justify the insurer's assertion of a pretextual legal dispute to cover up its refusal to accord the insured's reasonable expectation of a defense the consideration it is due in accordance with the covenant of good faith and fair dealing. *Tomaselli v. Transamerica Ins. Co.*, 25 Cal. App. 4th 1269, 1281 (1994) (genuine dispute doctrine not available where evidence reasonably supported inferences that insurer was "searching for ways to avoid paying the claim"); *Amadeo,* 290 F.3d at 1162 (genuine dispute doctrine not available to insurer that adopted

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[5] Unpublished federal decisions are "'citable notwithstanding California Rules of Court, rule 977, which only bars citation of unpublished *California* opinions. Therefore, [these cases are] citable as persuasive, although not precedential, authority.'" *Pac. Shore Funding v. Lozo*, 138 Cal. App. 4th 1342, 1352 n.6 (2006) (citations omitted).

pretextual interpretation of policy term and failed to conduct further investigation of insured's disability claim). *Accord Storrer v. Paul Revere Life Ins. Co.*, No. 05-15336, 2007 U.S. App. LEXIS 2896 at *4 (9th Cir. Feb. 5, 2007) (genuine dispute doctrine not available when insurer failed to conduct independent investigation and asserted pretext of insured's refusal to use particular form as basis for denying coverage); *Allstate*, 889 F. Supp. 374, 380 (C.D. Cal. 1995) ("If the insurance company's conclusion is not so unreasonable as to be a mere pretext for further investigation, the insurer is not liable for bad faith based on its conduct in the investigation.").

In this case, according to respondent's brief, it appears that Northern simply abandoned its investigation after determining that there was no California decision settling the question of how its pollution exclusion should be interpreted. (Respondent's Brief at 17-18.) Then, Northern refused to consider out-of-state authority supporting its insured's position that a sewage back-up into a private home did not constitute excluded "pollution" (*Id.* at 16-17.) Northern further refused to consider extrinsic evidence regarding the underwriting of the policy and reflecting that the parties intended the pollution exclusion to apply only to Griffin Dewatering Corporation's water reclamation business, not to its sewage pipe business. (Respondent's Brief at 8-11.)

Northern's refusal to consider the insured's out-of-state authority and extrinsic evidence would not support a finding that the dispute was genuine. Rather, as established in the cases cited above, an insurer's denial of coverage based on a superficial and biased investigation precludes the application of the genuine dispute doctrine. *See, e.g.*, *Jordan*, 148 Cal. App. 4th at 1074 (failure to conduct thorough investigation may provide basis for bad faith claim even where insurer's interpretation of policy language reasonable).

Northern cites several cases in its opening brief for the proposition that the genuine dispute doctrine applies in the duty to defend context (Appellant's Opening Brief at 26-27). In particular, Northern argues that the duty to defend should apply in this case because *MacKinnon* had not yet been decided when Northern denied coverage. However, while two of Northern's cited cases contain very little analysis of the genuine dispute doctrine, it does not appear that either one involved a failure to conduct a reasonable investigation. *See Am. Cas.*, 181 F.3d at 1123 (concluding simply that insured presented no evidence that insurer's construction of policy was unreasonable); *Lunsford*, 18 F.3d at 656 (concluding that, "[b]ecause [the insurer] investigated the insureds' claim and based its refusal to defend on that information and a reasonable construction of the policy, [the insurer] did not act in bad faith").

And, in Northern's lead case, *SEMX*, the insurer thoroughly investigated the facts and law applicable to the insured's claim and determined that ample out-of-state authority supported its position. 398 F. Supp. 2d at 1124. The insured in that case simply argued that a subsequent decision proved the insurer wrong and therefore the insurer had acted in bad faith. *Id.* The court concluded that, in such circumstances, the genuine dispute doctrine precludes a finding of bad faith. *Id.* "[T]he reasonableness of the insurer's decisions and actions must be evaluated as of the time that they were made." *Jordan*, 148 Cal. App.4th at 1073. However, as *SEMX* also points out "where there is doubt about a coverage issue, the insurer needs to err on the side of providing a defense." 398 F. Supp. 2d at 1122.

In stark contrast to *SEMX*, where the insurer investigated the insured's claim and, in light of authority and evidence supporting its interpretation, asserted a reasonable position, Northern appears simply to have grasped at the first straw that might obviate coverage and abandoned its investigation of the law or facts. *Compare Morris*, 109 Cal. App. 4th at 976 ("This is not a situation where an insurer is attempting to spin its one-shot success in convincing a single trial court of its position

into proof that the position was reasonable."). Indeed, contrary to the mandate of well-established authority, Northern not only disregarded legal authority that its insured asked it to consider, Northern also disregarded extrinsic evidence supporting the insured's interpretation. *See Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 39-40 (1968) ("PG&E") (establishing need to consider proffered extrinsic evidence to determine parties' intent regarding meaning of contractual language); *Dore v. Arnold Worldwide, Inc.*, 39 Cal. 4th 384, 391 (2006) (reaffirming *PG&E*'s view that extrinsic evidence must be provisionally considered, even when contract appears unambiguous on its face); *Am. Alternative Ins. Corp. v. Superior Court*, 135 Cal. App. 4th 1239, 1246 (2006) (noting that in determining whether an ambiguity exists, not only the face of the contract must be considered, but also any extrinsic evidence that supports a reasonable interpretation); *Lockheed Martin Corp. v. Continental Ins. Co.*, 134 Cal. App. 4th 187, 197 (2005) (in evaluating whether contractual language is ambiguous, "[t]he trial court must provisionally receive the extrinsic evidence in order to determine whether the language of the contract is 'reasonably susceptible' of the interpretation contended"). As noted above, Northern apparently ignored the evidence Griffin provided suggesting that both parties understood the pollution exclusion to apply only to Griffin's reclamation business. Additionally, as Northern admits, even though the claims adjustor in charge of Griffin's claim refused to consider cases supporting Griffin's position, Northern was aware of case law supporting Griffin's interpretation of the exclusion. (Reply Brief at 9, n.2.) Northern apparently chose to disregard these cases, as well.

Indeed, given the nature of Griffin's sewage business, it is difficult to imagine what Northern expected to cover if all accidents involving sewage were to be excluded by Northern's pollution exclusion. An insurer cannot reasonably assert an interpretation of its exclusion that would render coverage illusory. *Safeco Ins. Co. of*

Am. v. Robert S., 26 Cal. 4th 758, 764-65 (2001) (refusing to read exclusion so broadly as to render policy's liability coverage "practically meaningless"); *Maryland Cas. Co. v. Reeder*, 221 Cal. App. 3d 961, 977-78 (1990) (refusing to apply "alienated premises" exclusion to bar coverage for property damage liability when this would preclude *all* property damage coverage for insured); *Mills v. Agrichem. Aviation, Inc.*, 250 N.W.2d 663, 672 (N.D. 1977) (citing California decisions in rejecting exclusion for damage from substance discharged from airplanes when insured's business was crop dusting: "Would a reasonable man expect an airline trip coverage to cover his entire trip? Would an insured carrying bodily injury coverage expect to be covered when the bodily injury occurred in an altercation? Would a farmer reasonably expect coverage of all of his operation in a policy labeled "Farmer Liability Policy'?").

The genuine dispute doctrine should not apply to shield an insurer from a bad faith claim when, as it appears may be the case here, an insurer conducts one-sided investigation, looking for reasons to bar coverage, rather than to grant it. Otherwise, insurers would be encouraged to find whatever pretext they could and deny coverage as early as possible, abandoning their insureds without conducting a complete investigation. While an insurer is permitted to consider its own interests, it may not do so without according the insured's interests *at least* as much consideration as it accords its own. *Mariscal v. Old Republic Life Ins. Co.*, 42 Cal. App. 4th 1617, 1620 (1996) ("[A]n insurance company has a duty to diligently search for evidence which supports its insured's claim. If it seeks to discover only the evidence that defeats the claim it holds its own interest above that of its insured.").

When an insurer conducts an incomplete investigation, hiding behind a mere pretext of a defense, the genuine dispute doctrine should not be decided in favor of the insurer as a matter of law. In such circumstances, the insurer's legal position cannot be objectively tenable, and the insured's bad faith claim should not be decided as a matter of law. *See Delgado*, 152 Cal. App. 4th at 692 & n.16. When an insurer has

doubts about coverage, but no objectively tenable legal authority to support its position, the insurer should defend subject to a reservations of rights until, if and when, it completes its investigation and concludes reasonably that there is *no* potential for coverage, given the undisputed facts of the case. *Id. See also Scottsdale*, 36 Cal. 4th at 655.

V. THE TOUCHSTONE OF *BRANDT* FEES IS PROXIMATE CAUSATION OF DAMAGES RESULTING FROM AN INSURER'S BAD FAITH

A. *BRANDT* ALLOWS AN INSURED TO RECOVER ALL DETRIMENT PROXIMATELY RESULTING FROM AN INSURER'S BAD FAITH, INCLUDING ATTORNEY'S FEES THAT WERE INCURRED TO OBTAIN POLICY BENEFITS

Prior to *Brandt v. Superior Court*, 37 Cal. 3d 813 (1985), the California Courts of Appeal were split as to whether attorney's fees, reasonably incurred by an insured to compel payment of the policy benefits tortiously withheld by its insurer were recoverable as an element of damages resulting from the insurer's tortious conduct. *Compare Austero v. Washington Nat'l Ins. Co.*, 132 Cal. App. 3d 408 (1982) (denying insured recovery in tort action of attorney's fees incurred to obtain benefits under policy, reasoning California Code of Civil Procedure section 1021 precluded recovery of attorney's fees) *with Mustachio v. Ohio Farmers Ins. Co.*, 44 Cal. App. 3d 358 (1975) (holding attorney's fees incurred in connection with negotiations leading up to settlement of insured's policy claim properly included as element of damages in insured's later tort action for breach of duty of good faith and fair dealing). The split in authority stemmed primarily from the appellate courts' different analysis and application of the American rule and the "third-party tort exception."

The American rule "provides that each party to a lawsuit must ordinarily pay his own attorney fees." *Cassim v. Allstate Ins. Co.*, 33 Cal. 4th 780, 806 (2004). The California legislature codified the American rule in 1872 when it enacted Code of Civil Procedure section 1021, which now states:

> Except as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys and counselors at law is left to the agreement, express or implied, of the parties; but parties to actions or proceedings are entitled to their costs, as hereinafter provided.

Cal. Code Civ. Proc. §1021.

The "third-party tort exception," on the other hand, allows recovery of attorney fees in an action against a tortfeasor when "the one affected by the tort has been required to act in the protection of his interest by bringing or defending an action against a third person." *Prentice v. N. Am. Title Guar. Corp.*, 59 Cal. 2d 618, 620 (1963). The theory of recovery is that the attorney's fees incurred in litigating with the third person are recoverable as "damages wrongfully caused by the defendant's improper actions," rather than "the measure and mode of compensation of attorneys." *Id.* Therefore, the so-called "third-party tort exception" is not really an exception to the general rule.

Brandt addressed the conflict among the courts of appeal. In *Brandt*, the insured filed suit against its insurer for breach of contract, breach of the covenant of good faith and fair dealing, and violation of the statutory prohibitions against unfair claims practices after the insurer refused to pay a claim for disability benefits. 37 Cal. 3d at 816. The trial court struck portions of the insured's complaint seeking attorney's fees incurred in connection with his breach of contract cause of action as part of the damage resulting from breach of the insurer's duty of good faith and fair dealing, and the insured filed a petition for writ of mandate. *Id.*

Brandt held that when an insurer tortiously withholds benefits, the attorney's fees reasonably incurred by the insured to compel payment of the policy benefits are recoverable as an element of the damages resulting from such tortious conduct. *Id.* at 815. The court's reasoning built upon the foundational principle that an insurer is liable for any damages that are the proximate result of breach of an implied covenant of good faith and fair dealing:

> When an insurer's tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense. The attorney's fees are an economic loss—damages—proximately caused by the tort.

Id. at 817. The court concluded, therefore, that "when the insurer's conduct is unreasonable, a plaintiff is allowed to recover for all detriment proximately resulting from the insurer's bad faith, which detriment . . . includes those attorney's fees that were incurred to obtain the policy benefits and that would not have been incurred but for the insurer's tortious conduct." *Id.* at 819.

The court further explained that section 1021 applies only to attorney's fees *qua* attorney's fees. *Id.* at 817-19. Fees incurred in the pursuit of an insured's tort action, the court explained, would not be recoverable, as they constitute attorney's fees *qua* attorney's fees. *Id.* at 817. On the other hand, the court reasoned, fees incurred in the breach of contract action, or action for benefits due under the policy, are recoverable as damages proximately stemming from the insurer's improper acts. *Id.* at 817-18.

The court's holding was narrowly limited to its facts. For example, the court refused to decide *when* it is reasonable for an insured to incur attorney's fees to compel payment of policy benefits. *Id.* at 815 n.1. However, the court did provide additional guidance and instruction on the recovery of attorney's fees. By way of example, the court instructed that "the determination of recoverable fees must be made by the trier of fact unless the parties stipulate otherwise." *Id.* at 819. Additionally, the court advised that the "fees recoverable . . . may not exceed the amount attributable to the attorney's efforts to obtain the rejected payment due on the insurance contract. *Id.* "Fees attributable to obtaining any portion of the plaintiff's award which exceeds the amount due under the policy are not recoverable." *Id.*

A limitation on the amount of attorney's fees recoverable by an insured, therefore, does indeed exist. Understanding and proper application of the limitation,

however, comes only through a careful reading of *Brandt* and the factual context in which it was made, and analysis of subsequent case law explaining and interpreting *Brandt.* As will be revealed, blind application of *Brandt's* prohibition against fees in excess of "the amount attributable to the attorney's efforts to obtain the rejected payment due on the insurance contract" to a factually distinguishable scenario without an understanding of the rationale supporting recovery of attorney's fees, is misguided and likely to work an injustice on the insured.

B. CALIFORNIA SUPREME COURT DECISIONS REVEAL THE COURT'S DESIRE TO FULLY COMPENSATE AN INSURED FOR ALL COMPENSATORY DAMAGES UNDIMINISHED BY THE FEES AND COSTS INCURRED IN VINDICATING ITS RIGHTS WHEN ITS INSURER ACTS IN BAD FAITH

The California Supreme Court decisions following *Brandt* reveal the court's desire to allow an insured to fully recover its compensatory damages undiminished by the fees and costs incurred in vindicating its rights when an insurer acts in bad faith. In *White v. Western Title Insurance Co.*, 40 Cal. 3d 870 (1985), decided shortly after *Brandt*, the California Supreme Court concluded that the reasoning of *Brandt* "supports inclusion of witness fees and other litigation expenses as an element of damage" for breach of the covenant of good faith and fair dealing. *Id.* at 890.

More recently, in *Cassim,* 33 Cal. 4th at 812, the court stated that "*Brandt*'s focus was solely on ensuring that attorney fees for contract recovery did not diminish a plaintiff's compensatory damages award." The insurer in *Cassim* argued that the recoverable attorney's fees incurred by its insured under a contingency fee agreement should have been limited to a percentage of the contract benefits recovered. *Id.* at 805-13. The court, however, rejected the insurer's argument that *Brandt* limits the amount of fees awarded as damages to a percentage of the contract benefits. *Id.* at 809. The court explained:

> Certainly nothing in *Brandt* limits the amount of fees awarded as damages to a percentage of the contract benefits. We held in *Brandt* only that such fees "may not exceed the amount

> *attributable to the attorney's efforts* to obtain the rejected payment due on the insurance contract."

Id. The court went on to explain that the "key question is how much did it cost the insured—how much were her damages—to hire an attorney when her insurer acted in bad faith and denied benefits due her under her policy." *Id.* It reasoned that, "[t]o the extent some portion of that legal fee represents legal work that was related to both the tort and the contract recoveries and was thus at least partially '*attributable to the attorney's efforts to obtain the rejected payment due on the insurance contract,*'" failure to reimburse plaintiffs for a portion of that shared amount would necessarily diminish their contract recovery and violate *Brandt*'s premise that plaintiffs should recover, as tort damages, the legal fees incurred to recover their policy benefits." *Id.* at 810.

Even more recently, in *Essex Insurance Co. v. Five Star Dye House, Inc.*, 38 Cal. 4th 1252 (2006), the court, in ruling that *Brandt* fees are recoverable whether incurred by the insured personally or by its assignee, confirmed the insured's "right to recover the policy benefits in full, undiminished by the attorney fees incurred in bringing the action to recover those benefits." *Id.* at 1264. In contrast, the court explained, "attorney fees expended to obtain damages exceeding the policy limit or to recover other types of damages are not recoverable as *Brandt* fees." *Id.* at 1258. Subsequent supreme court decisions, therefore, indicate an unwillingness to narrowly restrict an insured's recovery under the rationale of *Brandt*. Instead, the court has repeatedly indicated its concern that the insured fully recover its tort damages.

C. APPELLATE COURT DECISIONS FURTHER AFFIRM AN INSURED'S RIGHT TO FULL COMPENSATION, UNDIMINISHED BY FEES AND EXPENSES INCURRED IN VINDICATING ITS RIGHTS WHEN ITS INSURER ACTS IN BAD FAITH

Appellate courts have also clarified and affirmed that the goal of *Brandt* is to allow an insured full recovery, undiminished by attorney's fees and costs incurred in vindicating its rights, when its insurer acts in bad faith. Shortly after *Brandt*, one appellate court stated that *Brandt* "held that insured parties may recover fees

expended to win policy benefits, where there has been tortious conduct by an insurer, because such fees are deemed to be a part of the damages proximately resulting from the tort of bad faith." *California Shoppers, Inc. v. Royal Globe Ins. Co.*, 175 Cal. App. 3d 1, 41 (1985). Similarly, another appellate court recently stated, "The insured is entitled to recover all policy benefits unreasonably withheld 'undiminished by the expenses incurred in retaining an attorney to recover under the policy.'" *Jordan*, 148 Cal. App. 4th at 1079.

The goal of full recovery is also revealed in decisions allowing an insured to recover all fees expended in pursuit of its breach of contract claim through disposition. Several courts, for example, have allowed recovery of pre-trial, trial, and post-trial costs incurred in pursuit of policy benefits. *See, e.g., Mosten Mgmt. Co., Inc. v. Zurich-American Ins. Group*, Nos. 00-15406, 00-15510, 2003 U.S. App. LEXIS 7963, at *5 (9th Cir. April 24, 2003) ("Thus, the fees awarded for pre-trial, trial, and post-trial work on the claim do 'not exceed the amount attributable to the attorney's efforts to obtain the rejected payment due on the insurance contract,' and are therefore recoverable." (citation omitted)); *McGregor v. Paul Revere Life Ins. Co.*, 369 F.3d 1099, 1101 (9th Cir. 2004) ("We are convinced that if the California Supreme Court were to address this issue, it would hold that *Brandt* fees are recoverable for fees incurred in defending against an insurer's appeal."); *Track Mortgage Group, Inc. v. Crusader Ins. Co.*, 98 Cal. App. 4th 857, 871 (2002) (determining insured entitled to fees on appeal to extent insurer's appeal attacked judgment in favor of insured on contract cause of action). *But see Burnaby v. Standard Fire Ins. Co.*, 40 Cal. App. 4th 787, 789 (1995) ("disagreeing with the trial court that *Brandt* permits the recovery of attorney fees on appeal.") Indeed, recovery of attorney's fees has even been held to extend to fees that were incurred to prove both a contract and tort claim. *See Mission Power Eng'g v. Continental Cas. Co.*, No. 95-55839, 1996 U.S. App. LEXIS 30690, at *4 (9th Cir. Nov. 22, 1996) ("where the

fees in question were incurred to prove the contract claim, recovery is not diminished because the work also helped to prove the tort claim").

Additionally, the reasoning behind this Court's decision in *Emerald Bay Community Association v. Golden Eagle Insurance Corp.*, 130 Cal. App. 4th 1078 (2005), is not inconsistent with *Brandt*'s view that an insured should recover all damages proximately caused by an insurer's wrongdoing. In *Emerald*, this Court refused to allow recovery of *Brandt* fees when an insured brought suit against one of its insurers for breach of contract and breach of the covenant of good faith and fair dealing after another insurer had provided the bulk of defense costs and the settlement. *Id.* at 1096. Notably, however, the Court did not state that recovery of *Brandt* fees is unquestionably and immediately terminated upon an insurer's conditional payment of policy benefits. Instead, this Court reasoned that the attorney's fees were not recoverable because the insured "was not reasonably compelled to retain coverage counsel to protect its rights," due to the fact that it was already protected by another insurer. *Id.*

In sum, the courts have refused to narrowly apply the rationale of *Brandt*. Instead, courts interpret *Brandt* and apply its rationale to provide the insured with full compensatory damages when its insurer has acted in bad faith. These damages include attorney's fees whether incurred pre-trial, trial, or post-trial in pursuit of policy benefits, as well as all fees incurred to prove the insured's entitlement to benefits under the policy. The limitation imposed by *Brandt* is simply to ensure that an insured's recovery does not include fees solely attributable to pursuit of its claims beyond breach of contract.

VI. AN INSURED SHOULD NOT BE DENIED *BRANDT* FEES ON THE SOLE BASIS THAT THEY WERE INCURRED AFTER CONDITIONAL PAYMENT OF POLICY BENEFITS

A. *BRANDT* PROHIBITS RECOVERY OF ONLY THOSE FEES INCURRED TO RECOVER BEYOND A BREACH OF CONTRACT CLAIM

The factual context of *Brandt* must be kept in the forefront of any analysis and subsequent application of the limitation set forth in *Brandt*. Otherwise, misinterpretation of the Court's language is likely to lead to unjust results. To begin, it is important to note from *Brandt* that the insurer had not paid any benefits to the insured under the policy. *Brandt*, 37 Cal. 3d at 815-16. For this reason, the insured's breach of contract action was synonymous with an action "for benefits due under [its] insurance polic[y]." *Id.* at 818-19 ("the first part of the present action, i.e., for benefits due under insurance polices"). It is logical, therefore, to read the court's limitation against fees in excess of those incurred "to obtain the rejected payment due on the insurance contract" as a limitation only against fees incurred in excess of the insured's breach of contract action.

It is also important to recognize that the court did not address, or even appear to consider, the situation at hand—one in which an insurer was found to have breached its contract and acted in bad faith, despite having conditionally paid benefits due under the policy. Accordingly, the court's instruction against recovery of fees in excess of "the amount attributable to the attorney's efforts to obtain the rejected payment," should not be read as a prohibition against recovery of fees incurred after the conditional payment of policy benefits. *Brandt* simply did not address that factual scenario.

Subsequent case law makes clear, however, that an insurer may breach the implied duty of good faith and fair dealing even if it pays the policy benefits. *See, e.g., Provident Life & Accident Ins. Co. v. Van Gemert*, 262 F. Supp. 2d 1047, 1052 (C.D. Cal. 2003) ("Where an insurer in bad faith pays benefits under a reservation of rights and files a declaratory relief action regarding insurance coverage, the insurer

may be liable for a breach of the implied covenant"); *Scottsdale Ins. Co. v. Weiss Eng'g & Development, Inc.*, Nos. 93-55365, 93-55420, 1996 U.S. App. LEXIS 15707, at *9-16 (9th Cir. June 11, 1996) (finding insurer breached implied covenant of good faith and fair dealing despite insurer's defense and indemnification of insured and awarding insured attorney's fees on appeal); *Morris*, 109 Cal. App. 4th at 977 ("In our view, an insurer's decision to continue payments under a reservation of rights, rather than cut off benefits entirely where it concludes there is no coverage, goes to the issue of damages, not liability."); *Dalrymple*, 40 Cal. App. 4th at 512-515 (1995) (reasoning that despite insurer's fulfillment of contractual duties through indemnification and payment of attorney's fees under reservation of rights, its pursuit of declaratory relief action "could be done for reasons indicating bad faith").

Reading *Brandt* to preclude recovery of any attorney's fees incurred after the conditional payment of policy benefits, despite an insurer's bad faith and the insured's continued accrual of attorney's fees in vindicating its breach of contract rights, therefore, flies in the face of *Brandt*'s rationale. Instead, the rationale of *Brandt*, which is clarified by subsequent case law, supports an insured's recovery of the entirety of its attorney's fees incurred in vindicating its breach of contract rights when its insurer acts in bad faith.

B. AS A GENERAL RULE, A TORT VICTIM MAY RECOVER ALL DAMAGE CAUSED BY THE TORTFEASOR, WHETHER IT COULD HAVE BEEN ANTICIPATED OR NOT

Statute and well-established case law make clear that the general rule of damages in tort is that the injured party may recover for all detriment caused whether it could have been anticipated or not. *See* Cal. Civ. Code § 3333; *Crisci*, 66 Cal. 2d at 433 ("The general rule of damages in tort is that the injured party may recover for all detriment caused whether it could have been anticipated or not."). Indeed, California Civil Code section 3333 provides:

> For the breach of an obligation not arising from contract, the measure of damages, except where otherwise expressly provided

> by this code, is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not.

Cal. Civ. Code § 3333.

While continued accrual of attorney's fees in the litigation of an insured's breach of contract claim even after conditional payment of policy benefits may not be customary or anticipated, the fees still stem from the insurer's initial bad faith when the bad faith compels the insured to file suit or defend a declaratory judgment action. Therefore, all attorney's fees incurred in prosecution or defense of an insured's breach of contract claim should be recoverable upon a finding of the insurer's bad faith, regardless of the timing of the payment of policy benefits.

Adopting the date of a conditional payment of policy benefits as a date certain on which recovery of *Brandt* fees is terminated deprives an insured of the full compensation allowed by statute and case law. This is so because termination of an insured's breach of contract claim, or its defense of a declaratory judgment action, will not necessarily coincide with the conditional payment of policy benefits. Instead, as was apparently true in this case, insureds may continue to accrue fees in prosecution of a breach of contract claim through disposition. In this case, as noted in Griffin's Respondent's Brief, Northern continued to assert that there was no coverage throughout the trial. (Respondent's Brief at 36, 63-70.) Thus, although Northern paid certain benefits, it also continued to dispute that those benefits were due and to seek reimbursement of them. (*Id.* at 26, 34, 66.)

Indeed, according to Respondent's Brief, Northern compelled Griffin's continued litigation through trial. (RB 26-27, 34-35, 57, 66, 68-70.) Griffin did not litigate its case to fruition against Northern by choice. *Id.* Moreover, Griffin only sought *Brandt* fees incurred before the trial court's October 2005 pre-trial ruling, which concluded that the underlying claim was covered. Not until this ruling was Northern's payment unconditional and no longer subject to recoupment.

Thus, an insured may be compelled to defend an insurer's declaratory judgment action after receipt of policy benefits. Depriving an insured of the fees incurred after such a conditional payment of policy benefits, without consideration of any other factor, therefore, flies in the face of well-established law concerning recovery of tort damages and works an injustice to the insured.

C. ALLOWING RECOVERY OF ATTORNEY'S FEES AFTER CONDITIONAL PAYMENT OF POLICY BENEFITS WILL NOT EXPOSE AN INSURER TO EXCESSIVE *BRANDT* FEES

Many protections are already in place to protect insurers from excessive payment of an insured's attorney's fees. "In order to recover. . .*Brandt* fees . . . the insured is required to plead and prove (1) the amount to which the insured was entitled to recover under the policy, (2) that the insurer withheld payment unreasonably or without proper cause; (3) the amount that the insured paid or incurred in legal fees and expenses in establishing the insured's right to contract benefits and (4) the reasonableness of the fees and expenses so incurred." *Jordan*, 148 Cal. App. 4th at 1079. To begin, then, only an insurer acting in bad faith is subject to *Brandt* fees. Additionally, as *Cassim* points out, insurers are protected from excessive *Brandt* fees because the insured "bears the burden of proving by a preponderance of the evidence both the existence and the amount of damages proximately caused by the insurer's tortious acts or omissions." *Cassim*, 33 Cal. 4th at 813. Moreover, "trial courts retain discretion to disregard fee agreements that appear designed to manipulate the calculation of *Brandt* fees to the [insured's] benefit." *Id.* Finally, California Civil Code § 3359 protects the insurer against unreasonable damages, because it provides:

> Damages must, in all cases, be reasonable, and where an obligation of any kind appears to create a right to unconscionable and grossly oppressive damages, contrary to substantial justice, no more than reasonable damages can be recovered.

Cal. Civ. Code § 3359. Therefore, many checks are already in place to ensure that the fees imposed as damages are not excessive. The insurer, for example, may first argue against a finding that its acts or omissions constituted bad faith. Additionally, the insurer may attack the fees as unsupported by a preponderance of the evidence, unreasonable, not proximately caused by the insurer's acts, or manipulated by a fee agreement.

Furthermore, allowing the insured to recover attorney's fees incurred after conditional payment of policy benefits will not extinguish the insurer's incentive to promptly pay policy benefits prior to resolution of breach of contract litigation. When an insurer acts in bad faith, it opens itself up to a potential award of punitive damages, for an insured may recover punitive damages upon a showing of clear and convincing evidence that the insurer acted with oppression, fraud, or malice. *See* Cal. Civ. Code § 3294(a). "Malice" is defined as "conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others." *Id.* § 3294(c)(1). "Oppression" is defined as "despicable conduct that subjects a person to cruel and unjust hardship in conscious disregard of that person's rights." *Id.* § 3294 (c)(2). If the insurer is found to have acted with oppression, fraud, or malice, the jury may award punitive damages based, in part, upon "how reprehensible" the insurer's conduct was. 2 Judicial Council of California Jury Instructions, Series 3900, § 3945 (2007). Accordingly, the insurer has an additional, independent incentive to promptly pay benefits due or in dispute; prompt payment should weigh against an insured's punitive damage claim, or at the very least, reduce the amount of punitive damages recoverable.

VII. CONCLUSION

Given the significance of the duty to defend, the genuine dispute doctrine should not apply where an insurer has failed to fully investigate an insured's claim .

and legitimately determine that there is a non-pretextual legal issue that may bar coverage. Even then, the insurer should defend subject to a reservation of rights, rather than outright denying the insured's claim, unless the facts establish *no* potential for coverage under a clearly established legal standard. Additionally, when, as in this case, an insurer continues to dispute coverage through trial, *Brandt* fees are properly awarded, where an insurer refuses to pay policy benefits unconditionally. Otherwise, the insured will be forced to prosecute a coverage action against its insurer, based on a coverage position the insurer took in bad faith, without the benefit of full compensation for damages caused by the insurer's misconduct. For these reasons, the verdict should be affirmed at least as to these issues.

DATED: July 19, 2007

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DATED: July 19, 2007

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APPENDIX

DAILY JOURNAL NEWSWIRE ARTICLE
http://www.dailyjournal.com

Message from sender:
New Heeseman article
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July 13, 2007

GENUINE DISPUTE
FOCUS COLUMN

By Rex Heeseman

A while ago, California courts started to grant pretrial motions for summary adjudication against a bad-faith claim for extracontractual damages (compensatory and punitive). The courts initially implemented this procedure if an insurer provided a sufficiently persuasive rationale for its position, whether ultimately correct or not, regarding a legal issue relating to the availability or the extent of coverage. See, for example, *Opsal v. United Services Automobile Association*, 2 Cal.App.4th 1197 (1991).

Birth of a Doctrine

The "genuine dispute" doctrine was extended later to a factual issue. See, for example, *Chateau Chamberay Homeowners Association v. Associated International Insurance Co.*, 90 Cal.App.4th 335 (2001). This doctrine naturally became a key component of an insurer's arsenal in bad-faith litigation.

The bad-faith bar is awaiting a potentially blockbuster decision. In April 2006, the California Supreme Court accepted review of *Wilson v. 21st Century Insurance Co.*, 136 Cal.App.4th 97 (2006). In reversing the granting of summary judgment for the insurer, the 2nd District Court of Appeal strongly indicated that the insurer did not properly consider the policyholder's claim; the court said that, if the insurer "failed to conduct a thorough investigation," then no "genuine dispute" could exist because of unanswered questions about the adequacy of its investigation.

In the context of bad-faith litigation, *Wilson* offers the Supreme Court its first opportunity in a long while to evaluate an insurer's obligation of investigating its policyholder's claim. See, for example, *Egan v. Mutual of Omaha*, 24 Cal.3d 1809 (1979), and *Frommoethelydo v. Fire Insurance Exchange*, 42 Cal.3d 208 (1986). Furthermore, the Supreme Court has never addressed the "genuine dispute" doctrine.

'Jordan's' Legacy

What has been happening very recently with this doctrine? The answer is *Jordan v. Allstate Insurance Co.*, 148 Cal.App.4th 1062 (2007) ("Jordan II"), and *Delgado v. Interinsurance Exchange*, 2007 DJDAR 9553 (June 27, 2007). Both decisions declined to apply the "genuine dispute" doctrine: *Jordan II*, like *Wilson*, because of an inadequate investigation; *Delgado* with reference to an insurer's failure to defend regarding a factual controversy.

Jordan II sprang from prior litigation between the parties, *Jordan v. Allstate Insurance Co.*, 116 Cal.App.4th 1206 (2004) ("Jordan I"). There, the court found an ambiguity in Jordan's homeowners policy and

remanded the case, primarily to determine whether an "entire collapse" had happened. On remand, Allstate asserted that, because *Jordan I* found reasonable its denial of coverage based on the "wet or dry rot" exclusion, there could be no bad faith because of a "genuine dispute" over coverage. Jordan retorted with a list of triable issues of fact regarding Allstate's lack of investigation, issues that might constitute bad faith.

The trial judge agreed with Allstate. The *Jordan II* court reversed, stating that, "although Allstate's interpretation of a policy exclusion was reasonable, it also had a duty to investigate Jordan's coverage claim that was based on the 'additional coverage' provisions relating to an 'entire collapse.'"

Footnote 7 added, "To the extent that Allstate in fact failed to fully investigate Jordan's collapse claim, particularly after our decision in *Jordan I*, it could be found to have violated the implied covenant of good faith and the fact that this litigation was pending would not excuse such violation." That footnote referred to *White v. Western Title Insurance Co.*, 40 Cal.3d 870 (1985), for the proposition that an insurer's legal duties do "not evaporate after litigation was commenced." (Is this a possible "revival" of *White*? When issued, that decision looked like a blockbuster, but it has had no impact of any consequence over the last 20 years.)

Consequently, because no investigation was in effect undertaken after the remand, Allstate could not invoke the "genuine dispute" doctrine; instead, Allstate has to face a bad-faith trial. This case turned from a legal dispute about coverage in *Jordan I* to a factual dispute about the efficacy of the "entire collapse" provision and related bad-faith allegations.

'Delgado' Case

In *Delgado*, the complaint in the underlying action said that the defendant, Reid, intentionally attacked the plaintiff, Delgado, or, alternatively, negligently used excessive force in the mistaken belief of exercising his right of self-defense. Reid's insurer refused to defend, contending its policyholder's assault was not an "accident" and, in any event, triggered the "intentional acts" exclusion. Delgado and Reid entered into an arrangement, with Delgado later suing Reid's insurer.

The *Delgado* court observed that, at the time of the tender, the complaint in the underlying action "alleged plainly that Reid acted in self-defense." Reid's insurer was then "*aware of allegations that gave rise to potential liability.* ... As a matter of law, [the] duty to defend was thus manifest."

In other words, at the time of the tender, the existence of an unresolved factual scenario "over whether Reid's actions were intentional or negligent" established that duty. Footnote 14 added, "whenever there is a *factual dispute* as to the existence of coverage, there is no reasonable basis for denying a defense. If an insurer does refuse a defense in such circumstance, it does so at its own risk."

Delgado therefore properly stated "a cause of action for the bad-faith refusal to defend." Although "a legitimate, arguable question" about a legal issue regarding the duty to defend "probably would" give rise to a "genuine dispute," a factual controversy would not. Still, whether Delgado actually suffered damages as a result of that denial and, if so, in what amounts had to be resolved after the remand.

Recent Developments

Two years ago, *CalFarm Insurance Co. v. Krusiewicz*, 131 Cal.App.4th 281 (2005), reversed an award of punitive damages because two justices said that the "coverage decision was objectively reasonable" because the case law "does not resolve, one way or the other, the precise coverage issue presented here." The dissent rejected the majority's "characterization of the applicable case law as unsettled"; instead, that case law was in effect too sparse to be considered as a valid "genuine dispute."

In *Century Surety Co. v. Polisso*, 139 Cal.App.4th 922 (2006), the insurer bottomed its "genuine dispute" defense on two factual questions. Simply because the insurer may have questioned matters with reference to the underlying action, the court observed, was irrelevant to its duty to defend. In other words, because there was no "genuine dispute" regarding the existence of that duty, no justifiable reason existed for the insurer's initial refusal to defend. (Note that, in several respects, *Polisso* is similar to *Delgado*.)

On the other hand, *Rappaport-Scott v. Interinsurance Exchange of the Automobile Club*, 146 Cal.App.4th 831 (2007), dismissed a bad-faith action on the basis of the "genuine dispute" doctrine, notwithstanding the policyholder's complaints about her first-party insurer's settlement offers. The court stressed that, because she had pursued an arbitration of an underinsured-motorist claim against that insurer, the plaintiff could not invoke a third-party legal standard with respect to that insurer's obligations.

Mixed Prognostications

Some recent decisions, such as *Jordan*, *Wilson* and *Polisso*, suggest that insurers may be "pushing the envelope" with the "genuine dispute" doctrine and therefore encountering some judicial resistance, conscious or otherwise. *Polisso* also suggests a similar trend with respect to motions in limine; see also *R & B Auto Center v. Farmers Group*, 140 Cal.App. 4th 327 (2006). Still, other recent decisions, such as *Krusiewicz* and *Rappaport*, reflect this doctrine's continued vitality.

Will the Supreme Court limit *Wilson* to "failure to investigate" issues? Or will the Supreme Court give further impetus to the "genuine dispute" doctrine? Will it select a simpler route, such as limiting this doctrine's

application to legal disputes completely or at least significantly? Will it jettison this doctrine?

The Supreme Court recently declined to review or depublish *Jordan II*. Is that a sign as to how the court will resolve *Wilson*? Will the resolution be influenced by the *Jordan* decisions? The author of those decisions, Justice H. Walter Croskey, also wrote *Chateau Chamberay*, often considered the leading case in the "genuine dispute" area.

Why have 14 months passed since the granting of review in *Wilson*, evidently with no hearing date? Are the justices divided in some way? Stay tuned.

Rex Heeseman is a judge on the Los Angeles County Superior Court. He is the co-author of The Rutter Group's practice guide on insurance litigation, and he has taught classes on the subject at Loyola Law School and UCLA Law School.

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July 19, 2007

Greg Wise