Appellate Court Finds Insured's Failure to Allege the Actual Theory of Liability on Which the Trial Court Based Its Judgment Requires Reversal of Bad Faith Judgment

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In a lengthy decision issued by the California Court of Appeal, Fourth Appellate District, and one that examined and summarized a whole host of liability insurance issues (including an insurer's duty to defend, what constitutes "unreasonable" conduct for "bad faith" purposes, how changes in the law impact the issue of bad faith, and the ability of an insurer to recoup defense costs under a reservation of rights), the court reversed an $11 million judgment against an insurer and then ruled in favor of the insurer.

Griffin Dewatering Corp. v. Northern Ins. Co. of New York, issued July 31, 2009, involved a groundwater pumping and control company that purchased a CGL policy from Northern Insurance Company. In exchange for renewing that coverage, Northern orally promised during a meeting in 1997 that it would not rely on the policy's total pollution exclusion with respect to "future" claims involving sewage. There had been a prior claim involving a faulty sewer bypass constructed by the insured that the insurer had denied. When there was a future claim that related to the prior claim, the insurer denied coverage again, and one of the questions was whether this future claim was covered by the oral promise. (The insurer shortly thereafter accepted coverage for the claim, but that did not short circuit the insured's bad faith lawsuit.)

The insured prevailed at trial against the insurer based on the oral promise, and it obtained a judgment of $11 million, mostly in bad faith tort damages. The insurer appealed and prevailed. The Court of Appeal based its decision in large part on the failure of insured to have actually pled in its complaint a cause of action based on the oral promise through which it had obtained the judgment. Instead, the complaint was predicated on the straightforward coverage question as to whether the insurer had misconstrued the language of the exclusion provision so as to unreasonably deny coverage. Moreover, the complaint had never been amended to include any "stand alone" cause of action based on the oral promise, and counsel for the insured conceded that it was only going to use the promise as a "concession" that the insurer's "coverage position had been unreasonable all along."

The Court of Appeal's decision, while very detailed, makes for interesting reading as it effectively distills current California law as to a number of bad faith and duty to defend topics. Further, the decision is interspersed with humor and a search for the real story, conceding in its opening words, "At first we did not know what to make of this case." By the end of the decision, the court had found the answer.