

Insurer's Reasonable Denial of Coverage Cannot be Rendered Retroactively Unreasonable Based on Subsequent Change in Law

Posted on August 11, 2009 by [Vivian Orlando](#)

In [Griffin Dewatering Corporation v. Northern Insurance Company of New York](#), ___ Cal. App. 4th ___, 2009 WL 2344762 (July 31, 2009), the Court of Appeal in the Fourth Appellate District issued a lengthy opinion explaining that an insurer's incorrect, but objectively reasonable, claim denial decision cannot be retroactively rendered unreasonable as a result of a post-denial judicial decision. In other words, there can be no bad faith if there is substantial case law in favor of the insurer's position at the time it makes its decision, even if that case law is later overturned.

Northern Insurance Company of New York ("Northern") issued a comprehensive general liability policy to Griffin Dewatering Corporation ("Griffin"), a company that was involved in certain sewer bypass projects. The policy contained a "total pollution exclusion," which Northern contended excluded sewage release from coverage. Northern relied on this provision in denying coverage and defense to Griffin.

In late 1995 and early 1996, Griffin performed work for South Coast Water District (the "District"). That work allegedly resulted in a backup of sewage into a private residence. The residents notified the District of the backup of sewage, asserting that the work being done on the sewer line (namely, the work being done by Griffin) resulted in the backup. Northern was notified of the claim. In April 1996, Northern denied coverage, taking the position that claims arising from the release of sewage were excluded from coverage based on the policy's total pollution exclusion.

The following year, 1997, Griffin's policy was up for renewal. In an effort presumably to retain Griffin's business, Northern allegedly promised at a meeting with Griffin that it would honor all future claims for release of sewage, despite the policy's exclusion. The purported promise was never reduced to writing. Griffin renewed coverage; however, the total pollution exclusion remained in the renewal policy in essentially the same form.

In 1999, after the District settled the residents' claims, it sued Griffin (and Northern) for indemnity. At that point, Griffin sought coverage from Northern, which again denied coverage based on the policy's total pollution exclusion. In April 2000, Griffin sued Northern for, among other things, breach of contract and bad faith. Griffin's complaint failed to mention the alleged oral promise by Northern to cover claims for release of sewage if the policy was renewed or the meeting in which that alleged promise was made. In September 2000, Northern decided to defend the District's lawsuit against Griffin, which Northern settled shortly thereafter. Northern also agreed to pay Griffin's fees and costs to date incurred in the bad faith action as part of a resolution of that action, which Griffin rejected.

Subsequently, while Griffin's bad faith action against Northern was pending, the California Supreme Court issued its decision in [MacKinnon v. Truck Insurance Exchange](#), 31 Cal. 4th 635 (2003), which held that a narrow construction of the total pollution exclusion is required. In October 2005, discussing the *MacKinnon* decision and misapplying another case, [CalFarm Insurance Co. v. Krusiewicz](#), 131 Cal. App. 4th 273 (2005) (in which the court found the insurer

was objectively reasonable in its denial), the trial court ruled *in limine* that Northern's denials under the policy were unreasonable (i.e., in bad faith) as a matter of law because the case law was unsettled at the time the insurer made its decision. The case was tried to verdict and Northern lost, the jury awarding Griffin \$1 million in compensatory damages (entirely consisting of attorneys' fees and costs) and an additional \$10 million in punitive damages.

Northern appealed. The Court of Appeal reversed the judgment in its entirety, holding that an insurer's reasonable, albeit incorrect, denial of coverage or defense could not be rendered retroactively unreasonable. The Court of Appeal held that the trial court's *in limine* ruling that Northern acted unreasonably in breaching the written contract was erroneous. In that regard, the Court of Appeal stated that the trial court erred in concluding that when the law is unsettled (as it was at the time of Northern's denial of a defense), it creates a potential for coverage. In addition to discussing well-established rules relating to the duty to defend, the Court relied on [*Morris v. Paul Revere Life Insurance Co.*](#), 109 Cal. App. 4th 966 (2003) to reach its conclusion. In doing so, the Court of Appeal not only rejected Griffin's argument that *Morris* was inapplicable in third party cases, it also adopted the *Morris* Court's reasoning, noting that an insurance company's denial may be deemed objectively reasonable if substantial legal precedent and the policy language supports the insurer's position. Because at the time Northern denied coverage there was substantial case law supporting its position, even though the Supreme Court in *MacKinnon* later reached a contrary conclusion, Northern's prior denials could not be deemed unreasonable based on this new case law.

With respect to Northern's purported oral promise of coverage, the Court of Appeal concluded that because Griffin failed to refer to that oral promise in its complaint and never sought to amend the complaint to add that claim, it could not rely on it as a basis for damages. Thus, Griffin could not assert that it was entitled to damages based on Northern's breach of the alleged oral promise since this cause of action was never alleged.

Finally, the Court of Appeal found that Griffin had no contract damages as a result of Northern's denial as Northern ultimately settled all litigation against Griffin and it or an excess insurer paid all Griffin's attorneys' fees incurred in that litigation. As to tort damages in this action, Griffin's claims were based on a finding of unreasonableness, which was incorrect. Thus, neither contract damages, nor tort damages, including attorneys' fees, were available. As a result, the Court of Appeal directed judgment to be entered in favor of the insurer.