



Court of Appeals Limits the Application of the Genuine Dispute Doctrine in Third Party Insurance Coverage Cases

The genuine dispute doctrine received another blow as the California Court of Appeals held that the doctrine may not be used to refuse settlement in third party coverage cases. The recently decided case of *Howard v. American National Fire Ins. Co.*, ___ Cal. App. 4th ___, 2010 WL 3156851 (decided August 11, 2010), involved allegations of priest molestation by an employee of the Roman Catholic Bishop of Stockton (“Bishop”). American National Fire Insurance Co. (“American”) provided liability insurance to Bishop that covered bodily injury caused by an employee’s battery. When Howard filed suit for negligent retention of the molesting priest, Bishop asked American to defend and indemnify against the suit. American refused on the grounds that the alleged molestation occurred after the policy had expired in November of 1979. In support, American relied on deposition testimony by Howard in which he stated that his first memory of being molested was when he was five or six years old, the earliest of which would have been seven months after the policy had expired. The case continued to trial and Bishop was found liable for negligent retention and directed to pay \$5.5 million in compensatory and punitive damages. While the case was still on appeal, the parties settled and Howard agreed to join Bishop in a suit against American to recover on the judgment and for bad faith failure to defend, settle, and indemnify against the molestation case.

A number of issues and defenses were raised in the subsequent suit against American. Relevant for this discussion was American’s assertion of the genuine dispute doctrine as a defense against Howard’s allegations of bad faith. Under the genuine dispute doctrine, if the insurer can show that a genuine dispute existed as to coverage, then it is entitled to summary judgment on the insured’s bad-faith cause of action. Here, American argued, there was a genuine dispute as to whether the molestation occurred during the policy period. Although Howard alleged in his complaint that the molestation occurred sometime between 1977 and 1991, American argued that the only evidence presented at trial showed that the molestation occurred after the policy expiration. The weakness of this argument was that the underlying trial did not focus on **when** the molestation occurred, but rather **whether** it occurred. Therefore, the subsequent suit against American was not limited to the evidence offered at the previous trial. Further, the court held, the genuine dispute rule does not apply in all bad faith insurance contexts.

In first party cases, where payment is sought for the insured’s direct losses, an insurer may raise a reasonable dispute over coverage without being guilty of bad faith. But it has never been held that an insurer in a third party case may rely on a genuine dispute over coverage to refuse settlement. Instead, it is a long-standing rule that “the only permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim’s injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer.”

Id. (internal citations omitted). Essentially, American's dispute over coverage could not justify its failure to refuse settlement and should not affect its evaluation of whether a settlement offer is a reasonable one. American had a duty to the insured to evaluate and participate in the settlement negotiations despite the potential coverage issues. In addition, the court noted that a genuine dispute exists only where the insurer's position is maintained in good faith and on reasonable grounds. Here, the court found that American distorted Howard's deposition testimony by equating his memory of specific acts of molestation into an admission that no molestation occurred during the policy period. This, the court decided, was unreasonable and evidence of bad faith.

The key takeaway in this case is the narrowing of the genuine dispute doctrine. The court's opinion essentially limits the doctrine's use as a defense in bad faith failure-to-settle cases and reinforces the principle that the mere hint of potential coverage invokes the duty to defend.



By: M. Scott Koller
Associate
McKennon|Schindler LLP
384 Forest Avenue, Suite 20
Laguna Beach, California 92651
877-MSLAW20
(877) 675-2920