Open Source: A Challenge Worth Meeting

Gwyn Firth Murray

Introduction

Since the author first started working with open source software, there has been a staggering increase in the amount of software that is freely available and in the number of associated licenses. A decade ago, the world of open source licensing was limited to only a few licenses. The most widely used and recognized was the governing license of Linux, the GNU General Public License (GPL), along with its "lesser" license, the GNU Lesser General Public License (LGPL). Other important and commonly used licenses were the Berkeley Software Distribution (BSD) license and the Apache license. (Each of these licenses can be viewed at http://www.opensource.org/licenses/)

Since then, new open source applications and corresponding licenses have multiplied exponentially, and the task of understanding the terms that govern the wide variety of open source licenses has become more of a challenge. It has also become more

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Insurance "Bad Faith" Basics, Part II

Guy O. Kornblum

Part I of this article appeared in 24 CEB Cal Bus L Prac 96 (Summer 2009). It addressed third-party cases based on an insurer's failure to settle an insured party's claim and presented a three-tier analytical framework for first-party cases: breach of the insurance contract, the tort of insurance bad faith, and the availability of punitive damages. This Part II addresses the insurer's duty to investigate, the insurer's defense of "good faith dispute" (also known as the "genuine issue" rule), and damages. It concludes with the author's comments on trial of an insurance bad faith case.

FIRST-PARTY CASES
(Continued)

Duty to Investigate

The duty to investigate is an important duty of an insurer. Hence, a failure to investigate can be an important aspect of a bad faith case. The erroneous withholding of policy benefits based on an insurer's failure to investigate a claim properly may constitute a breach of the implied covenant of good faith and fair dealing. See, e.g., Wilson v 21st Century Ins. Co. (2007) 42 Cal. 4th 713, 68 CR3d 746. To protect the insured's peace of mind and security, "an insurer cannot reasonably and in good faith deny payments to its insured without thoroughly investigating the foundation for its denial." Egan v Mutual of Omaha Ins. Co. (1979) 24 Cal. 3d 809, 819, 169 Cal. Rptr 691 (emphasis added). An insurer must "fully inquire into possible bases that might support the insured's claim." 24 Cal. 3d at 819 (emphasis added). The investigation must be prompt, thorough, reasonable, and conducted in good faith, i.e., the insurer must consider facts favorable to the insured's position as well as those that favor the insurer. This is one aspect of the insurer's duty to give equal consideration to both the insurer's and the insured's interests. 24 Cal. 3d at 818.

California has codified the duty to investigate in the Unfair Practices Act (UPA) (Ins C §§790-790.15), which requires the insurer "to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies." Ins C §790.03(h)(3). Even though no private right of action exists under this statute (Moradi-Shalal v Fireman's Funds Ins. Cos. (1988) 46 Cal. 3d 287, 304, 250 Cal. Rptr 116), the application of the duty to investigate remains important. The UPA confirms the industry standards. Alternatively, other standards may be adopted by the company as fair standards for processing a claim. A violation of statutory, industry, or self-imposed standards provides support for a bad faith claim, and the
The erroneous withholding of policy benefits based on an insurer’s failure to investigate a claim properly may constitute a breach of the implied covenant of good faith and fair dealing.

An insurer’s duty to investigate arises when the insurer has sufficient notice of the insured’s claim. The insured must make a good faith effort to comply with the notice of loss provisions in the insurance policy. However, for a tort action to lie for breach of the implied covenant of good faith, the insurer must have had actual notice of the claim. Constructive notice of a claim is sufficient only to support an insured’s action for breach of contract. As stated in California Shoppers, Inc. v Royal Globe Ins. Co. (1985) 175 CA3d 1, 57, 221 CR 171,

[which] while constructive notice has significance in determining contractual liabilities, it has no application [regarding tort liabilities]. More particularly, without actual presentation of a claim by the insured in compliance with claims procedures contained in the policy, there is no duty imposed on the insurer to investigate the claim.

Nonetheless, the insurer’s duty to investigate is independent of the insured’s duty to comply with the policy provisions. Thus, an insurer may be required to make an independent inquiry if the insured failed to supply requested information regarding the claim. “[A company does not] exhibit good faith in denying a claim merely because an insured failed to dot the i’s or cross the t’s on a claim form...” McCormick v Sentinel Life Ins. Co. (1984) 153 CA3d 1030, 1046, 200 CR 732.

The Insurer: Good Faith Dispute Defense

Background

Recent cases have allowed insurers to defend against charges of bad faith by raising the “good faith dispute” or “genuine issue” rule. The genuine issue rule was articulated by the Ninth Circuit Court of Appeals in American Cas. Co. v Kreiger (9th Cir 1999) 181 F3d 1113, which allowed district courts to conclude as a matter of law that an insurer’s denial of a claim would not be considered unreasonable as long as there existed a “genuine issue as to the insurer’s liability.” 181 F3d at 1123 (quoting Lunsford v American Guar. & Liab. Ins. Co. (9th Cir 1994) 18 F3d 653, 656). Until its decision in Guebara v Allstate Ins. Co. (9th Cir 2001) 237 F3d 987, the Ninth Circuit had usually interpreted the genuine issue rule to mean an uncertainty as to the applicable law. California courts adopting and applying the genuine issue rule similarly applied it to coverage disputes arising from questions of law, i.e., disputes over policy interpretation or areas of unsettled and uncertain law.

In Fraley v Allstate Ins. Co. (2000) 81 CA4th 1282, 97 CR2d 386, the insurance industry made its first inroad towards extending the genuine issue rule to factual disputes. In that case, the insured’s evidence of bad faith consisted solely of the discrepancy between his expert’s estimate of repairs and Allstate’s estimate of repairs. The court noted that “[t]he ‘genuine dispute’ doctrine may be applied where the insurer denies a claim based on the opinions of experts,” and that when the parties rely on expert opinions, “even a substantial disparity in estimates for the scope and cost of repairs does not, by itself, suggest the insurer acted in bad faith.” 81 CA4th at 1292.

The Guebara Decision

In Guebara, the Ninth Circuit relied on Fraley to extend the genuine issue rule to factual disputes. Surmising how the California Supreme Court would decide the issue, the Ninth Circuit held that the rule should be applied on a case-by-case basis (Guebara, 237 F3d at 994):

Rather than establish a bright-line rule, we hold that the genuine dispute doctrine should be applied on a case-by-case basis. In some cases, the application of the rule to purely factual disputes will be inappropriate. In others, investigations by a defendant’s independent experts will permit the invocation of the doctrine and summary judgment for the defendant on a bad faith claim.

Chateau Chamberay

In Chateau Chamberay Homeowners Ass’n v Associated Int’l Ins. Co. (2001) 90 CA4th 335, 108 CR 776, the California court of appeal officially extended the genuine issue rule to factual disputes. The Chateau Chamberay Homeowners Association (HOA) suffered earthquake damage to its condominium complex and submitted a claim to its insurer, Associated International Insurance Company (AIIC), for approximately $5.8 million in repairs. Many of the items included in its claim, however, were clearly not covered under its policy, including work required for building code upgrades and repairs for preexisting damage over which HOA had actually
filed a design defect suit 14 years earlier. After hiring an adjuster to assist in adjustment of HOA’s loss and retaining the services of a general contractor and structural engineer to evaluate the nature and extent of the damage, AIC paid nearly $2 million to HOA and claimed no further amounts were owed under the policy.

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HOA filed suit, and AIC moved for summary judgment on the bad faith claim. HOA did not dispute a single fact AIC submitted in support of its motion. The evidence being undisputed, the trial court concluded that AIC’s conduct was not unreasonable as a matter of law. HOA’s contract claim thereafter proceeded to arbitration. The arbitrator concluded AIC owed approximately $600,000 in policy benefits. The total covered amount was therefore just 45 percent of HOA’s original claim, and AIC paid 85 percent of the total covered amount before any lawsuit was filed.

Against this factual context, the court of appeal considered whether the granting of summary judgment in AIC’s favor was appropriate. In affirming summary judgment, the court concluded (1) that a “genuine dispute” existed between AIC and HOA over what portion of HOA’s claim was covered and the proper amount of the covered loss, and (2) that HOA failed to offer any factual support for its claim that AIC had acted unreasonably or without proper cause in its adjustment of the claim.

The court expressly adopted the genuine issue rule as applicable in factual disputes, stating that “we see no reason why the genuine dispute doctrine should be limited to legal issues.” 90 CA4th at 348. The court cautioned that its opinion “does not mean, however, that the genuine dispute doctrine may properly be applied in every case involving purely a factual dispute between an insurer and its insured. This is an issue which should be decided on a case-by-case basis.” 90 CA4th at 348 (emphasis added), citing Guebara, 237 F3d at 994. First, the particulars of the factual dispute itself must be undisputed. Then, “[p]rovided there is no dispute as to the underlying facts (e.g., what the parties did and said),... the trial court can determine, as a matter of law, whether such dispute is ‘genuine.’” 90 CA4th at 348 n7 (emphasis in original).

The California Supreme Court Speaks

In Wilson v 21st Century Ins. Co. (2007) 42 C4th 713, 68 CR3d 746, the California Supreme Court reversed the trial court’s granting of summary judgment in a case in which the plaintiff-insured sought the $100,000 policy limits in underinsured motorist benefits as a result of a motor vehicle accident with an automobile driven by a drunk driver. (Plaintiff collected $15,000 from the drunk driver’s carrier, leaving her with a claim for a balance of $85,000 against her own uninsured motorist coverage.) 21st Century based its motion on the “genuine dispute” regarding the value of the claim. The California Supreme Court rejected the insurer’s position, observing (42 C4th at 754):

The genuine dispute rule does not relieve an insurer from its obligation to thoroughly and fairly investigate, process and evaluate the insured’s claim... [A]n insurer is entitled to summary judgment based on a genuine dispute over coverage or the value of the insured’s claim only where the summary judgment record demonstrates the absence of triable issues [citation] as to whether the disputed position upon which the insurer denied the claim was reached reasonably and in good faith.

The court found that 21st Century had not met this burden because it had not demonstrated that it had thoroughly and fairly investigated, processed, and evaluated the insured’s claim. See 42 C4th at 726.

Comment

For plaintiff’s counsel to overcome the genuine issue rule, it is crucially important in the first instance to clarify the scope of this principle for the trial court. In fact, the genuine issue rule is not a rule at all. It is applied on a case-by-case basis and can only be applied if the underlying facts creating the so-called genuine issue are undisputed. If any of the underlying facts are in dispute, the genuine issue rule cannot be applied as a matter of law. Although both Guebara and Chateau Chamberay listed several examples of biased investigations when the principle should not apply, the courts still reviewed the record as a whole to determine whether the insurer acted “reasonably” and “with proper cause”—the long-established standard for determining bad faith liability without reference to any genuine issue rule. See McCoy v Progressive W. Life Ins. Co. (2009) 171 CA4th 785, 90 CR3d 74, in which the court ruled that an insurer is not entitled to a jury instruction on the genuine dispute doctrine because an instruction requiring a plaintiff to prove that the insurer acted unreasonably in its investigation necessarily requires the jury to find that no genuine dis-
pute existed regarding the appropriateness of the investigation.

It is therefore unclear exactly what the genuine issue rule is. Under Chateau Chamberay, if there are no underlying disputed facts and no factor negating application of the rule exists, then the principle "may" apply. At that point, the court's task is to review the record as a whole to determine whether the insurer acted reasonably and with proper cause. Yet, that is the same standard long applied in bad faith cases. What, therefore, does this principle add to the analysis? Apparently nothing. Under Wilson, the most that can be said is that when it is undisputed that an insurer has reasonably relied in good faith on an independent expert and no other evidence of bad faith exists, the insurer's conduct would be deemed reasonable as a matter of law.

Exactly when courts will apply the genuine issue rule and when they will not remains to be seen. The principle should not allow insurers to insulate themselves from bad faith liability merely by paying a hired gun to issue a report on which they could then rely to deny benefits. Many of the so-called independent experts are anything but independent, having been repeatedly retained by insurer after insurer.

Converting Contract to Tort Damages

Using traditional tort principles (see, e.g., Fletcher v Western Nat'l Life Ins. Co. (1970) 10 CA3d 376, 400, 89 CR 78) or the requirements for the tort of insurance bad faith, plaintiffs must convert the contract claim to a tort in order to recover extra-contractual damages. This requires going outside the four corners of the contract and examining carefully the conduct of the insurer in administering and managing the claim. See, e.g., Life Ins. Co. of Georgia v Johnson (1997) 701 So2d 524; Gruberg v Aetna Ins. Co. (1973) 9 C3d 566, 108 CR 480; Best Place, Inc. v Penn Am. Ins. Co. (Haw.1996) 920 P2d 334.

DAMAGES

Requirement of Financial Loss

Courts have discussed the question of whether the claim for insurance bad faith is a personal injury claim or an economic claim, i.e., a property claim, and have generally described it as the latter. See Waters v United Servs. Auto. Ass'n (1996) 41 CA4th 1063, 1078, 48 CR2d 910. As a result, financial injury must occur before there can be an award for emotional distress. 41 CA4th at 1079. See also Continental Ins. Co. v Superior Court (1995) 37 CA4th 69, 86, 43 CR2d 374.

As a general proposition, the requirement of financial injury serves to verify an accompanying claim for emotional distress. As one California court of appeal stated (Waters, 41 CA4th at 1072, quoting Crisci v Security Ins. Co. (1967) 66 C2d at 433, 58 CR 13):

The principal reason for limiting recovery of damages for mental distress is that to permit recovery of such damages would open the door to fictitious claims, to recovery for mere bad manners, and to litigation in the field of trivialities... Obviously, where, as here, the claim is actionable and has resulted in substantial damages apart from those due to mental distress, the danger of fictitious claims is reduced, and we are not here concerned with mere bad manners or trivialities but tortious conduct resulting in substantial invasions of clearly protected interests.

Emotional Distress Recovery

Severe Distress Not Required

To recover for emotional distress in a case involving insurance bad faith, it is not necessary that such distress be severe. Waters, 41 CA4th at 1073; Clayton v United Servs. Auto. Ass'n (1997) 54 CA4th 1158, 63 CR2d 419. See also CACI 2350.

Proximately Caused by the Financial Loss?

Similarly, to recover for emotional distress, it is not necessary to prove that the emotional distress is proximately caused by a financial loss, only that both emotional distress and financial distress were caused. As one court noted (Clayton, 54 CA4th at 1161):

[Plaintiff in a bad faith case must prove some economic loss as a means of validating the seriousness of his or her emotional distress. Once economic loss is shown, however, the plaintiff is entitled to recover for all emotional distress proximately caused by the insurer's bad faith without proving any causal link between the emotional distress and the financial loss.

Attorney Fees

In a bad faith action, the insured may recover attorney fees that were derived from the insured's action to recover benefits under the insurance policy. However, fees that are the result of the insured's efforts to collect extra-contractual damages (i.e., emotional distress damages or additional economic damages beyond the policy's coverage) are not recoverable. Attorney fees are only recoverable under

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COMMENTS ON THE TRIAL OF AN INSURANCE BAD FAITH CASE

Generally

There are many issues for plaintiff’s counsel to consider in preparing for a trial of a bad faith case. For example, is the plaintiff willing to allow the defense to explore his or her emotional background before a jury, which is likely if the plaintiff wants to pursue an emotional distress claim? If there are coverage issues, is the court likely to bifurcate the trial so that the first phase will be limited to issues relating to breach of contract? The first phase is likely to be a court trial only. If so, the court will likely not hear evidence relating to claims handling (which may color the coverage decision) until the coverage issue is resolved.

What privilege issues might come up? Is the insurer likely to apply a privilege to large portions of the claim file? Will the insurer assert the affirmative defense that it relied on the advice of counsel and therefore acted reasonably and in good faith? This defense can pose a dilemma for the insurer, because it may result in a waiver of the attorney-client privilege. If so, what is the scope of the waiver? It is also unclear whether "advice of counsel" is an affirmative defense that must be pled or is simply an issue to be considered when determining whether the insurer acted reasonably. Questions also arise regarding the "objectivity" of the advice.

"Pattern and practice" cases ... have great potential for showcasing insurance company misdeeds and expanding on the themes as embedded in the industry.

Theme of the Case: Emotional Issues

Attorneys prosecuting a bad faith claim must also consider the theme of the case. Insurance litigation similar to other types of cases involving individuals against large corporations. A few decades ago, the popular corporate target was the railroads. Now, it seems to be insurance companies. Insurance cases have the same type of David-versus-Goliath theme, which has even been recognized in appellate court decisions. See, e.g., Republic Ins. Co. v Hires (Nev 1991) 810 P2d 790, 796. A plaintiff’s case should support themes surrounding preconceived notions about large insurance companies:

- Their goal is to make money, often at the expense of insureds and policyholders;
- Insurance policies are designed to give insurers opportunities to deny claims;
- The claims process has built-in impediments that delay payment so that insurance companies can hold on to their money as long as possible;
- Insurance company employees are less than candid, are puppets of executive management, and are "taught" to tell the company story rather than the truth.

The question that must be considered is, what are plaintiff’s counsel’s chances of getting jurors to commit to these emotional themes? The greater the commitment, the greater the chance that the jury will accept the plaintiff’s evidence and arguments that there has been wrongdoing in the handling of the plaintiff’s insurance matters and that damages must be awarded to right the wrong and potentially prevent such evil from occurring in the future.

"Pattern and practice" cases are cases involving conduct in which the insurer customarily engages or conduct that is imbedded in company policy. These cases have great potential for showcasing insurance company misdeeds and expanding on the themes as embedded in the industry. Moreover, these cases
may allow class claims, which can increase the seriousness of the case in the eyes of the court and jury—and the insurance company defendant—and they offer the potential for admission of other claimants’ stories, which can enhance the potential for punitive damages. A continued practice of misdeeds may represent corporate policy and, if wrongful, should be a ripe candidate for punishment and deterrence, which is the object of punitive damages. See, e.g., *Merrick v Paul Revere Life Ins. Co.* (9th Cir 2007) 500 F3d 1007; *Moore v American United Life Ins. Co.* (1984) 150 CA3d 610, 637, 197 CR 898; *Downey Sav. & Loan Ass'n v Ohio Cas. Ins. Co.* (1987) 189 CA3d 1072, 1098, 234 CR 835.

**The Venue: Judge and Jury Considerations**

Judge and jury considerations are important in any case, including cases involving insurance claims. Plaintiff’s counsel must evaluate who will preside over the case and what type of jury the plaintiff will have. What will be the emotional responses? Are there legal barriers that the judge is likely to accept? What is the current temperature of the community towards insurance companies and big business in general? Does the plaintiff have an employment or personal history (e.g., a successful businessman, a police officer, or a member of a minority group) that is likely to provoke any hidden prejudices of jurors?

**Cost-Benefit Analysis: Logistical Considerations**

At the outset it is important for plaintiff’s counsel to understand what the plaintiff’s financial commitment will be. Whether the costs of suit are funded by the client or shared or fronted by the attorney, considerable expense can result from an improvidently accepted case. The cost of travel and deposition can run into thousands of dollars. Cases involving experts and witnesses from around the country can run up expenses enormously, and the end result may not justify the dollars expended. Although these factors should be considered in any plaintiff’s case, they are extremely important in litigation challenging major corporations with significant litigation budgets.

**Will Experts Be Needed?**

Insurance and claims expert witnesses have become fixtures in extra-contractual insurance cases. These experts can be both a useful tool and a damaging obstacle. Attorneys, judges, and independent (i.e., outside) qualified claims personnel are being called on to testify as experts about (1) the reasonableness of settlement offers; (2) the standard or customary practice of insurance companies and their employees and agents; and (3) the ultimate issue of whether the insurer-defendant, or other defendants, acted in bad faith or in violation of their respective implied or statutory obligations. Usually, the experts are so-called retained experts, engaged solely for the purpose of giving opinions on issues in the case, as distinct from insurer employees who, because of their involvement in a claim file, will testify on the facts of the case.

[A] persuasive expert for the defense may totally defuse the plaintiff’s punitive damages claim even though the trier of fact decides that the claim decisions were wrong.

This development raises a number of questions:

- Is an insurer’s bad faith or alleged wrongdoing an improper subject for expert testimony? (This issue may be raised first in a motion in limine to exclude the expert’s testimony.)
- When is an expert necessary to the case?
- Where can plaintiff’s counsel find such experts?
- How can the experts be used effectively by either the plaintiff or defendant in an extra-contractual action?

An expert on claims issues may have an impact on the punitive damages claim. A court is not likely to permit such an expert to testify regarding the state of mind of the insurer in handling the claim, i.e., whether the claims handling was fraudulent, malicious, or vexatious. See Fed R Evid 704. However, an expert’s testimony on claims issues may impact the jury’s view of the case and ultimately affect punitive damages issues. See *Garnett v Transamerica Ins. Servs.* (Id 1990) 800 P2d 656, 667. In *Garnett*, the Idaho Supreme Court allowed the jury to consider the implications of an insurance expert’s testimony that the insurer’s claims file was “an extreme deviation of the standard of care in claims handling” in deciding whether to award punitive damages.

The plaintiff’s expert may establish a case of claims mishandling so clear so as to compel punitive damages. However, a persuasive expert for the defense may totally defuse the plaintiff’s punitive
damages claim even though the trier of fact decides that the claim decisions were wrong. Nonetheless, the need for experts must be assessed and the added expense considered in determining how plaintiff’s counsel should manage a bad faith case.

CONCLUSION

The law with respect to insurance bad faith cases is in a constant state of flux. Nevertheless, bad faith cases offer an opportunity for early resolution for several reasons.

First, they are expensive for plaintiff’s counsel to prepare and try. Understanding the case early, evaluating the damages, and looking at down-the-line costs should motivate both sides to review the case to see whether mediation at an early stage is prudent.

Second, insurance bad faith cases present a unique opportunity for an early evaluation. If there are coverage issues, they can be evaluated by reviewing the policy provisions and applicable law. Because there is already a paper trail, i.e., the claims file, there is an excellent source of information to prepare a chronology of claims handling and learn what was done and why. Once the pertinent files are obtained, counsel should have considerable information about the claims handling, and the reasoning, or lack of reasoning, behind it.

Pertinent insurance company files can be obtained and reviewed early in the case. The materials may include underwriting and claims files as well as industry and company manuals in order to evaluate how the claim was handled, i.e., what was done and why. Plaintiff’s counsel should interview the plaintiff and plaintiff’s representatives, such as brokers, and obtain files for review. On the defense side, the insurer’s counsel should interview company personnel to determine the basis for underwriting and claims decisions. In some cases, the parties might agree on limited early discovery with a view toward mediating once they have completed this preliminary discovery or informal exchange of information.

With some early effort, the parties to an insurance bad faith case should be able to explore a resolution of the case before they begin the process of protracted litigation. From all perspectives, this is just common sense because so much is already available by the time the case has been filed.