

BAD FAITH BLOG

One Reasonable Basis for Denying Coverage Defeats Bad Faith in Iowa

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Summary: Pella Corporation, an Iowa company, was a defendant in two class action cases in Illinois. Those cases alleged that Pella's windows were defectively designed and manufactured. Liberty Mutual filed a declaratory judgment action in Iowa federal court contending it owed no coverage. The District Court ruled that Liberty Mutual had a duty to reimburse Pella's defense costs, but denied Pella's bad faith denial of coverage claim. The Eighth Circuit affirmed the bad faith ruling on appeal.

Liberty Mutual Insurance Co. v. Pella Corp., 650 F.3d 1161, (8th Cir. Iowa) 2011 W.L. 3611485

Pella found itself a defendant in Illinois state and federal court class action cases alleging that Pella defectively designed and manufactured windows which resulted in damage to those windows. The plaintiffs in the underlying cases alleged multiple theories of recovery. Liberty Mutual denied coverage, but entered into an apparent cost-sharing agreement with Pella's pre-2001 carriers to pay portions of the defense costs. Thereafter, it filed a declaratory judgment action contending that it had no duty to reimburse Pella.

The Eighth Circuit reviewed several arguments Liberty Mutual raised in support of its coverage denial. The Eighth Circuit held that several of Liberty Mutual's positions were not supported by the policy language and controlling authorities.

However, Liberty Mutual raised one issue on appeal which led it to victory. In addition to its losing arguments, Liberty Mutual denied coverage on grounds that there had been no "accident" so there was no covered occurrence which led to property damage. The Eighth Circuit reviewed, at some length, the Iowa Supreme Court's ruling in *Purcell Construction, Inc. v. Hawkeye Insurance Company*, 596 N.W.2d 67 (1999) for its definition of "accident" the undefined term in the policy used to define occurrence. Adopting the majority rule, the Supreme Court of Iowa concluded that "defective workmanship standing alone, that is, resulting in damages only to the work product itself, is not an occurrence under a CGL policy." The court also noted that "the damages [the developer] seeks is limited to the very property upon which Purcell performed work and were not the result of an occurrence as defined in the policy."

Relying upon that holding, as well as later Iowa case law, the Eighth Circuit held that “the plaintiffs in the [underlying class action] suits did not allege property damage caused by an occurrence.” Furthermore, “the property damage—whether to the windows themselves or the structures of the building near the windows—was caused by a defect that Pella was alleged to have known about. Under Iowa law, such defective workmanship... cannot be considered an occurrence....” Because no occurrence had been alleged in the underlying class action cases, “Liberty Mutual did not owe Pella a duty to reimburse its costs in defending either action.”

Having ruled that there was no coverage, the court turned to Pella’s cross-appeal. Pella contended that under Iowa law all actions by an insurance company must be in good faith. Since the court had already determined that Liberty Mutual relied on several grounds which did not support the coverage denial, Pella contended that the denial was in bad faith. However, the court pointed out that in Iowa an insured has the burden of proving two elements to recover on a bad faith claim. Those grounds are: “(1) the [insurer] had no reasonable basis for denying the plaintiff’s claim or for refusing to consent to settlement, and (2) the [insurer] knew or had reason to know that its denial or refusal was without reasonable basis.” *Bellville v. Farm Bureau Mutual Ins. Co.*, 702 N.W.2d 468, 473 (Iowa 2005).

Quoting further from the *Bellville* case, the 8th Circuit noted that whenever there is “an objectively reasonable basis for denial of a claim..., the insurer cannot be held liable for bad faith as a matter of law.” Since the court had “concluded that Pella was not entitled to coverage for its defense costs in the [underlying class action] suits..., we necessarily conclude that Liberty Mutual had an objectively reasonable basis for denying Pella’s claim.” Even though Liberty Mutual had emphasized other reasons for the denial of coverage, it had also raised a proper basis for denying coverage. Accordingly, Liberty Mutual had “relied on a reasonable basis for denying coverage, [so] the district court properly granted summary judgment on Pella’s bad faith claim.”

Pella teaches that Iowa insurance companies must make sure that they have at least one reasonable basis for denying coverage in third party liability cases. Otherwise, it will be fairly easy for an insured to establish a bad faith claim.

By Anthony Martin

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