

BAD FAITH BLOG

Triable Fact Issues on Washington Bad Faith Claims

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Summary: Great American insured Bayley, a general contractor on a \$12.3 million renovation project in Orange County, California. After its air conditioning subcontractor was found to have violated California's prevailing wage law, the Community College District served Bayley with a "Notice of Withholding Contract Payments" as well as the procedural right to dispute the withholding. On cross-motions for partial summary judgment the district court found that Great American had a duty to defend which Great American had breached, but also found in favor of Great American on the statutory and non-statutory bad faith claims.

Bayley contracted with a community college district ("District") for a renovation project in Orange County, California. The project had a value of \$12.3 million. One of its several subcontractors was the HVAC contractor. A district compliance person found that contractor was violating California's prevailing wage law. The District notified the California state governing authority and requested approval of a forfeiture for the "amount of unpaid wages and penalties." After the state official approved the request, the District served Bayley with a Notice of Withholding Contract Payments. When Bayley sued the subcontractor, it dissolved and filed bankruptcy.

Bayley was insured by Great American on a professional liability policy. After Bayley tendered the claim to Great American, Great American denied the claim contending Bayley was not engaged in any professional services. The court found “the response and the notice, both of which Great American received at the time Bayley tendered its claim, could serve as a functional complaint.” The court rejected Great American’s argument that serving as a general contractor on a \$12.3 million construction project in California and ensuring the payment of “the prevailing wage” under California law on such a large construction project with multiple subcontractors was not engaging in professional services. Rather, a “liberal and reasonable construction” of the applicable facts would show that “ensuring subcontractors’ compliance with prevailing wage laws on a project of this scope required professional skill and judgment.” Because interpreting the language of an insurance policy is a question of law, summary judgment regarding the duty to defend was appropriate. Accordingly, in the cross-motions for summary judgment on the duty to defend issue, the court found that Great American did have a “duty to defend Bayley against the District’s withholding of contract payments,” and found that Great American had breached its duty to defend.

The court then turned to the bad faith arguments noting that Bayley had raised arguments that Great American’s investigation and denial of coverage constituted bad faith, that Great American had violated Washington’s Insurance Fair Conduct Act, and that as a result of Great American’s alleged bad faith, Great American was estopped from denying coverage. Quoting from the Washington Supreme Court’s opinion in *Overton v. Consol. Ins. Co.*, 445 Wash.2d 417, 38 P.3d 322, 329 (2002) the district court judge found that a Washington insurer “acts in bad faith if its denial of coverage is ‘unreasonable, frivolous, or unfounded.’” Furthermore, a claim for bad faith claims handling is “viable even if an insurer did not breach its duty to defend, pay, or settle.”

The district judge first found there were fact questions on the issue of whether Great American’s denial of a defense was unreasonable or unfounded. Specifically, whether Great American properly relied upon case law, had properly concluded that the “request and notice did not show that Bayley was performing ‘construction management,’” or properly concluded that the unpaid wages and penalties withheld were not covered losses. Finally, Great American demonstrated that Bayley’s own insurance brokers were uncertain and/or questioned whether there was coverage for this “claim.” Given these fact issues, the district court concluded Great American’s denial of coverage was not unreasonable or unfounded as a matter of law.

The court also considered whether Great American acted in bad faith by failing to conduct a proper investigation and found it had not. The district judge noted that Great American presented evidence that in the nearly two months after the tender it had requested, received, and reviewed additional information and documents from Bayley, consulted with Bayley’s insurance broker, retained a California labor law firm to advise it regarding California labor law, participated in a settlement conference, and drafted a legal coverage opinion. Given those facts, the court found a triable issue of fact regarding the reasonableness of its investigation.

Bayley had similarly argued that Great American had violated Washington's Insurance Fair Conduct Act for the way it had handled and investigated the claim. The Insurance Fair Conduct Act "establishes a cause of action for '[a]ny first party claimant to a policy of insurance who is unreasonably denied a claim for coverage.'" Based upon the court's earlier findings that there were triable issues of fact regarding whether Great American conducted a reasonable investigation, and whether it had reasonably denied the claim, the district court judge denied summary judgment on the IFCA claim as well. Because the court had denied Bayley's motion for summary judgment on the bad faith issues, the court also denied its motion for summary judgment which contended that Great American was "estopped from denying coverage."

The Bayley Construction case demonstrates that insurance companies in the State of Washington need to carefully and thoroughly conduct coverage investigations before issuing coverage denials. The meaning of professional services in Great American's professional liability coverage was not nearly as narrow as Great American argued. For that reason, the duty to defend arose. However, because Great American had conducted a nearly two month investigation which demonstrated that insurance professionals working on behalf of Bayley Construction thought Great American's position might be valid, helped convince the district court judge that there was at least a question of fact whether Great American had breached its duty of good faith. Insurers which conduct fair, balanced, and reasonable investigations can often ward off summary judgment findings of bad faith and require, at the very least, a finding by a jury on such an issue.

By Anthony L. Martin

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