

BAD FAITH BLOG

# No Bad Faith for the Denial of Uncovered Losses

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**Summary:** The insured's assignee argued Occidental Fire & Casualty Company of North Carolina breached the covenant of good faith and fair dealing by refusing to defend and indemnify the insured against a claim regarding faulty construction of shower walls in a hotel. The District Court for Arizona found because the insurer did not defend the insured in the underlying suit, it could assert new reasons for the denial of coverage. The court ruled the policies did not provide coverage, and there was no bad faith where the policies did not provide coverage.

*Desert Ridge Resort LLC v. Occidental Fire & Casualty Company of North Carolina*

West Coast Marble and Tile Contractor, LLC ("West Coast") purchased two CGL policies from Occidental Fire & Casualty Company of North Carolina ("Occidental") with policy periods from February 11, 2003 to February 11, 2004 and from February 11, 2004 to February 11, 2005. West Coast was a subcontractor on a project for new construction of a hotel owned by Desert Ridge Resort ("DRR"). The hotel opened in late 2002. In March 2010, DRR discovered significant water damage in the hotel's walls caused by construction defects in the shower stalls. DRR brought suit against West Coast and other subcontractors alleging negligence, breach of implied warranty, and indemnity. Another insurer defended West Coast in this action.

On March 27, 2012, West Coast filed a claim under the CGL policies with Occidental. On November 27, 2012, Occidental denied the claims on two grounds: (1) the damage manifested subsequent to the expiration of the policy period because it was not discovered until March 2010 and (2) the damage was caused by fungal growth that was excluded from coverage. The denial letter stated "we do not waive any of our rights or any of the other provisions or conditions of the policy."

DRR and West Coast entered into an agreement whereby the parties stipulated to entry of a \$12 million judgment in favor of DRR. West Coast assigned all of its rights, claims, and causes of action against Occidental to DRR, and DRR agreed not to collect on the judgment from West Coast. DRR filed suit against Occidental for breach of contract, bad faith, and declaratory judgment. Both parties filed motions for summary judgment.

In the lawsuit, Occidental asserted two additional grounds for denial of coverage, including the pre-existing damages clause and the “your work” exclusion. DRR argued Occidental could not rely on these grounds since they were not identified in Occidental’s original November 2012 denial letter.

The court extensively reviewed the backdrop of insurance law in Arizona and determined because Occidental had not defended West Coast in the underlying action, there was no prohibition on raising previously unidentified grounds for contesting coverage. Because there was no defense, there was no conflict of interest where the insurer was in a position during the underlying litigation to take advantage of the insured. DRR could not establish West Coast would have acted differently in defending the underlying action if it had known of the additional grounds for denial of coverage. Rather, the court found the information provided by West Coast to Occidental did not fully educate Occident of the claims by DRR or that the additional grounds were possibly applicable. Finally, the court determined there was no waiver of these additional grounds for denial because Occidental had expressly preserved the right to raise additional grounds for denial as more facts became available.

Following its decision that Occidental could assert the additional grounds for denial of coverage, the court determined the “pre-existing damages clause” excluded coverage under the policies because the alleged damage occurred in late 2002 when the hotel opened, and the first policy’s coverage did not begin until February 2003. The court denied DRR’s motion for summary judgment.

Finally, the court addressed DRR’s bad faith claims. First, DRR argued Occidental had acted in bad faith in failing to defend and indemnify West Coast. The court found, however, that this bad faith claim failed because it had found there was no coverage under the policy. DRR also claimed Occidental acted in bad faith in delaying responses and actions during the claims process. The court found DRR had failed to properly support this claim because it presented no evidence that West Coast suffered damages, either in the form of additional attorneys’ fees, expenses, or loss of the opportunity to settle the claim because of the delay. The court entered summary judgment in favor of Occidental on these claims.