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Delgado v. ACSC: Bad Faith and the Duty to Defend

By Samuel H. Ruby

In an opinion filed yesterday and certified for publication, the California Court of Appeal held that as a matter of law, an insurer committed bad faith by declining to defend a lawsuit over a bodily injury claim.

Craig Reid attacked and injured Jonathan Delgado. Delgado sued Reid, alleging battery (an intentional tort) but also negligence (specifically, unreasonable self-defense). Reid's homeowner's insurer (ACSC) declined to defend, contending that the complaint did not allege an "occurrence" and that Reid's conduct fell within an intentional acts exclusion and California's statutory "willful acts" exclusion. Reid reached a settlement with Delgado, in which he assigned to Delgado his rights against ACSC.

When Delgado sued ACSC, ACSC filed a demurrer, which the trial court sustained. The trial court acknowledged that Delgado had alleged a negligence claim but found that claim to have been "contrived" and "disingenuous." On appeal, Delgado argued that it is not a trial court's prerogative to make such determinations at the pleadings stage. The Court of Appeal agreed and reversed the order sustaining the demurrer.

Surprisingly, the Court of Appeal—not content merely to *reinstate* Delgado's complaint against the insurer—went on to grant him *judgment* on much of it. First, the court held that as a matter of law, ACSC had wrongfully refused to defend. The court explained that when a complaint makes allegations that would amount to a covered claim *if* true, the insurer may not decline a defense merely because the insurer believes that the allegations are *not* true.

Going even further, the court held that as a matter of law, ACSC's declination was in bad faith. The court categorized the issues concerning the negligence claim as a "factual dispute." The court opined that the "genuine dispute" doctrine does not apply where an insurer incorrectly denies a defense based on a "factual dispute," because as a matter of law, a "factual dispute" is never a valid reason for denying a defense. The court held that in the duty-to-defend context, only "legal disputes" can be "genuine disputes."

The court's blanket pronouncements concerning "factual disputes" are troubling, because they fail to distinguish "factual disputes" relevant to the insured's liability from "factual disputes" that are relevant only to coverage. It has long been understood that an insurer should not decline to defend a claim merely because it doubts the claim has merit and will result in a covered judgment—in other words, the insurer should not pre-judge the facts that are in dispute between the plaintiff and the insured. However, coverage sometimes turns upon a factual issue that is *irrelevant* to the merits of the plaintiff's claim. In such instances, the insurer should be entitled to decline coverage and should not automatically be liable for bad faith if the declination is later deemed incorrect.

Update. The Court of Appeal has modified its opinion. The new version still expounds on the issue of bad faith but stops short of granting judgment for Delgado. *Delgado v. Interinsurance Exchange of the Automobile Club of Southern California*, --- Cal. Rptr. 3d, 2007 WL 1810226.