

INSURANCE UPDATE

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California Law – Liability Insurance – Bad Faith – Representations Of Agent/Broker

An Insurer May Not Be Held Liable For Bad Faith Breach Of Reformed Insurance Policy Where Unreformed Policy, As Written, Provides No Coverage

By David P. Borovsky and Howard M. Garfield

R&B Auto Center, Inc. v. Farmers Group, Inc. – 06 C.D.O.S. 4950, California Court of Appeal, Fourth District, June 9, 2006

R&B Auto, car dealership selling only used cars, prepared a written request for business operations insurance to a Farmers insurance agent. The request specifically sought coverage for liability associated with automobile “lemon laws”. The agent allegedly told R&B that the policy promised contained such coverage for R&B’s business, and R&B bought the policy. In fact, the policy issued contained only “lemon law” liability for the sale of new automobiles, which R&B did not sell.

R&B was sued under the lemon laws relating to the sale of a used automobile. The insurer denied the tender of defense, based on the language of the policy. R&B sued the carrier, asserting claims for misrepresentation, breach of contract, reformation, bad faith, and unfair competition.

Through a series of motions in limine and two motions for nonsuit, the trial court largely gutted R&B’s case, and R&B appealed an adverse judgment. The appellate court reversed and remanded, concluding as follows.

First, R&B could validly state claims against its insurer for misrepresentation and reformation, based on the representations allegedly made by its agent concerning the scope of insurance coverage promised. An insurance agent has an obligation to use reasonable care to procure the coverage requested by the insured, and the “failure to deliver the agreed-upon coverage” may constitute actionable negligence, for which the insurer may be held vicariously liable. In addition, these representations, if proved, could reform the terms of the policy to include coverage for “lemon law” liability for used cars as well. Assuming reformation was proved, R&B could then recover contract damages for breach of the reformed contract.

However, critically, the appellate court held that R&B could not validly state a claim for bad faith against the insurer for denying the tender of defense. This was because the insurer, in denying coverage for the lemon law claim, did so based on the language of the policy as written, which undisputedly did not provide

“lemon law” liability coverage for used cars. Thus, the insurer acted reasonably in denying the claim, which was fatal to any claim for bad faith. The appellate court rejected R&B’s argument that a bad faith claim could be based on a breach of the insurance policy as reformed. Although the court acknowledged that no California case had ever addressed the issue, it reasoned that it would be unfair to hold an insurer liable for bad faith for failing to have the foresight to know that the policy would be reformed sometime in the future.

This case is a victory for insurers in California. It clarifies a formerly uncertain issue under California law, and creates an important limitation on the circumstances under which an insurer may be held liable for bad faith and associated extra-contractual damages.