

BAD FAITH BLOG

Almost Getting It Right Does Not Foreclose a Bad Faith Suit in Colorado

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Summary: American Family insured the Dunns who had sewer and water backup flooding in their basement. That flooding led to a mold build up and them vacating the house. The vacant and unheated house during a Colorado winter resulted in water pipes freezing and breaking. Despite a payment of the full policy limits, the Dunns had the right to pursue a bad faith claim for allegedly bad faith conduct due to delays and the manner in which American Family adjusted the claim.

Michael Dunn v. American Family Insurance, 251 P.3d 1232 (Colo.Ct.App. 2010)

The Dunns had a string of bad luck which began with a sewer backup in their basement. Their property and casualty insurer, American Family, provided the Dunns with contact information for a remediation company, Insurance Contractors and Associates (ICA). Unfortunately, ICA did not succeed in its task and black mold was detected near the furnace. Thereafter, the plaintiffs left their home. After ICA's remediation attempts failed, the Dunns hired a second, then a third, and then a fourth contractor to finish the work on their house. The house was vacant during the winter months, which resulted in the water pipes breaking. All during this time the mold continued to spread, which caused the Dunns to replace all of the contents in the home. American Family ended up paying approximately \$340,000 to the Dunns. The Dunns were not satisfied with this payment and filed suit against American Family alleging a bad faith breach of their insurance contract.

The Dunns did not claim that American Family withheld insurance benefits. Instead, the Dunns alleged that American Family breached its good faith duty to them by failing to appropriately screen ICA both for its expertise and liability insurance coverage, and also failing to appropriately monitor ICA's remediation efforts. In addition, they claimed there was a good faith breach by American Family failing to advise the Dunns appropriately about the potential mold contamination and the possibility of plumbing freezing and causing further damage. Finally, the Dunns alleged American Family breached its good faith duty by failing to "communicate with plaintiffs and [their second contractor] regarding policy claims and coverage." American Family's "breach" allegedly caused the Dunns "extreme mental anguish and emotional distress" as a result of their loss and the substantial inconvenience they endured.

American Family moved for summary judgment on grounds that it had not breached any legal duty owed to the Dunns. The trial court ruled for American Family finding that its duty was to “adjust claims in good faith” and that American Family’s tort liability for breach of the duty of good faith and fair dealing arose only when it “refuses or delays payments owed to the insured.” The trial court judge ruled that the claims asserted by the Dunns were “unrelated to the adjustment and payment of claims” and, for that reason, the Dunns had no proper “claim for bad faith breach of contract.”

Colorado recognizes the tort for breach of the implied duty of good faith and fair dealing. An insured has a first party bad faith claim for that breach whenever the insurer “(1) unreasonably denies an insured the benefits of his or her policy; (2) knowing that its conduct is unreasonable, or in reckless disregard of its lack of reasonableness.” In Colorado all aspects of payment of a claim, including the adjustment, fall within an insurer’s good faith duty to its insured. Prior cases in Colorado recognized that a bad faith claim is viable “even if the express terms of the contract have been honored by the insurer.” Any insurer acting unreasonably and with knowledge or disregard can be found liable “in tort for the breach of the covenant of good faith and fair dealing.” In determining whether such a breach has taken place, courts in Colorado look to the Colorado statutes describing insurer unfair or deceptive trade practices.

The court fairly easily dispatched with the first two claims asserted by the Dunns. The court agreed with American Family that it did not have a good faith duty to monitor or supervise ICA, an independent contractor. Although the appellate court in Colorado had not previously dealt with the issue, it looked to decisions from other states before concluding that the duty of good faith and fair dealing did not require insurance companies to “ensure that any contractor it recommends for repair or remediation work will perform satisfactorily,” especially when that contractor is an independent contractor hired by the insured. In fact, the court stated that whenever the insured selects and retains that independent contractor, even if recommended by the insurance company, the insured has primary responsibility for supervising the contractor absent any representation that the insurer would assume that duty.

In addition, the court concluded that American Family had no “good faith duty to ensure that the home was adequately heated, or to warn plaintiffs about the potential for mold contamination.” The court looked to the policy which required the Dunns to take reasonable steps to repair the property and protect it from any further damage, and noted that that is a fairly typical insurance policy requirement. The court also noted that American Family was not required to cover the cost of damage resulting from the frozen pipes which then burst and caused additional damage. Despite that lack of duty, American Family did cover that cost. The Dunns argued that they were entitled to recover damages in tort “because defendant had a good faith duty to make sure that the home was winterized while it was unoccupied.” The Colorado Court of Appeals disagreed with that novel argument and further rejected the Dunns’ argument that American Family was required “to warn plaintiffs that flooding could cause further damage to their home, including mold.” Instead, the court noted that it was American Family’s obligation to “cover the cost of mold remediation to the limits of plaintiffs’ insurance policy,” which it had done.

That was the good news for American Family. The bad news resulted from the fairly uncontroversial ruling that American Family “had a good faith duty to adequately and promptly communicate in the course of investigating and handling [the Dunns’] claim.” That ruling led to a reversal and remand to the trial court to conduct a trial “on the remaining questions of whether defendant breached its good faith duty to communicate and, if so, whether and to what extent plaintiffs were injured by that breach.” Because the court recognized that its finding was a matter of first impression in Colorado, the court then gave an “advisory opinion” on issues to be addressed at trial. Although the court disagreed that the trial judge had to listen to an expert witness on whether American Family had a good faith duty to plaintiffs, the court stated that such testimony “may be relevant to the determination of whether [American Family] acted unreasonably in this regard” and that the expert could give an opinion whether American Family knew that its conduct was unreasonable or whether it acted in reckless disregard of such unreasonableness which caused injury to the Dunns.

The record clearly demonstrated that American Family had paid the Dunns everything they were entitled to under the policy. The only issue left for trial was whether American Family had acted unreasonably in the handling of the claim to include (1) whether its communications with its insureds and the contractors the insureds retained were confusing regarding what was or was not covered; (2) whether the “unreasonable conduct” alleged by the Dunns was known by American Family to be unreasonable; and (3) whether confusing communications on coverage issues during the claims handling resulted in further damages to the Dunns. Without stating so directly, the court seemed somewhat skeptical about the ability of the Dunns to prove up their case while making it clear that the court believed they were entitled to make that attempt. Furthermore, that decision could not be made on summary judgment.