Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
September 2017 Issue

Evangeline Fisher Grossman
EVANGELINE FISHER GROSSMAN LAW

Christopher Dion

Bad faith, genuine dispute, and the "expert safe-harbor"

HOW INSURANCE COMPANIES USE BIASED EXPERTS TO DENY AND UNDERPAY CLAIMS, AND WHAT TO DO ABOUT IT

Egregious cases of insurance companies engaging in predatory consumer behavior have swelled over the past decade, bolstered by unscrupulous, unethical and unlawful business practices. Well known are stories of insurers: unreasonably delaying settlement long after benefits are due; ignoring evidence and focusing only on those facts which support denial; and/or forcing the insured into an appraisal or arbitration proceeding, likely beyond the means of an insured, in an effort to reduce the amounts paid.

One predatory practice that has gone largely unassailed in California is the insurance industry's use of biased experts to pretextually manufacture support for claim denials. This practice rarely gains recognition, either by the courts or in the press. Only when a scandal makes the headlines, often in the context of a national catastrophe, does the issue rise to the level of public awareness. Last year, the television program *Frontline* aired a special on the insurance industry's use of biased experts to manufacture grounds for denial of claims arising from Superstorm Sandy in 2012. Similar abuses were exposed in Congressional hearings following the Hurricane Katrina disaster in 2005. Likewise, the same practices were laid bare in court cases and news coverage following the industry's response to the Oklahoma tornadoes in 1999, which in part fueled the investigation into the Hurricane Katrina abuses. Other cases have exposed these outcome-oriented opinions in non-catastrophic insurance claims; and some of these have even risen to national prominence, such as in the mid-2000's when UNUM was exposed for retaining biased medical experts to support the denial of disability claims.

The fundamental underpinnings of this predatory insurance practice revolve around the "relationship" between the expert and the insurance company. As the logic goes, the experts are gainfully employed by providing repeat opinions for insurance companies on loss causation and the extent and amount of damages. They are financially motivated to provide opinions helpful to the insurers: if they do, they receive future assignments. Because insurance companies offer significant ongoing business, many experts who depend on insurance companies for their employment offer contrived opinions that allow insurance companies to reduce or eliminate the amounts owed on claims.

It's worse in California

In California, although insureds have lodged similar complaints with respect to claims adjustments following fire and earthquake catastrophes, the biased-expert issue has yet to garner the same publicity as in other national disasters. And for California's insureds, much has changed since the last major slew of earthquake-related claims in the late 1990's, and decidedly not for the better. A string of California state-court cases over the past 20 years has lessened the

See Grossman & Dion, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
September 2017 Issue

gains made by plaintiffs' attorneys in insurance bad-faith law, effectively incentivizing insurance companies to use biased experts to deny claims. While the courts have never endorsed the use of biased experts – nor would they if they knew – the uniform approach by the courts to this issue has accomplished nearly the same result.

These practices are particularly insidious as insurance companies can and do prey upon insureds who they know lack the ability to redress this abuse. Insurance companies often obtain uninformed, voluntary consent from the insured for an inspection by a biased expert; or the carrier invokes the policy's "cooperation" clause, either as a precursor to evaluating the claim or in conjunction with the policy's "right to sue" clause. Insurance companies can thus systematically deny benefits to which their insureds contracted and are otherwise entitled under the law. The insured seldom has the ability to contest the denial, simply because knowledgeable insurance counsel are unwilling to accept the contingency risk of a small claim, and the insurance company's reliance on an expert provides a shield against any and all bad faith and punitive damage claims.

This article examines the development of the "expert safe-harbor" defense in the context of the genuine-dispute doctrine and the universal success by the insurance industry over the past 17 years in using biased experts. It concludes with thoughts on how to overcome the practice and protect the rights of the insured.

Development of insurance "bad faith" and the "genuine-dispute doctrine"

California first recognized a tort action for breach of the implied covenant of good faith and fair dealing in a third-party insurance claim in *Crisci v. Security Ins. Co.* (1967) 66 Cal.2d 425. The central tenet of the tort is "unreasonable conduct" by the insurer. The covenant of good faith and fair dealing is breached where an insurer delays or denies payment of policy benefits *unreasonably* (i.e., without any reasonable basis for its position) or *without proper cause*.

Following *Crisci,* the California courts began a decades-long expansion of the insurance "bad faith" tort. The courts extended the insurance "bad faith" action to first party claims, and provided for punitive damage recovery for breach of the covenant. The courts also created numerous categories of behavior that were *a priori* deemed to be "unreasonable," such as an insurer failing to properly and thoroughly investigate a claim, an insurer engaging in abusive practices to avoid payment of the claim, and an insurer misrepresenting matters or misleading the insured. Well known are the public policy reasons attributed to the unique tort status afforded insurance disputes under contract law, including in particular the insured seeking peace of mind and security in exchange for making payment in advance of loss.

However, over the last 20 years the tables have turned radically against the insureds. In 1991, the insurance industry won a decision of little consequence at the time, but which set the stage for later decisions that would profoundly alter the bad faith landscape. In *Opsal v. United Services Auto. Ass'n* (1991) 2 Cal.App.4th 1197, the court held that an insurer could not be found liable for bad faith if it maintained a "genuine dispute" with its insured over the interpretation of the law. This case gave birth to the genuine-dispute doctrine (also known as the genuine-issue defense). A few years later the genuine-dispute doctrine was extended to reasonable but differing constructions of the policy between the insurer and the insured.

For nearly a decade following *Opsal*, the genuine-dispute doctrine languished in relative obscurity, consigned to those disputes involving legal issues. Thus its application was severely restricted – generally to those cases where a valid dispute existed concerning the interpretation of a policy provision. Only then would the defense successfully defeat an allegation of insurer bad faith.

Fraley v. Allstate brings seismic shift

A decade after *Opsal*, the insurance industry's expanding use of the genuine-dispute defense underwent a seismic shift. In *Fraley v. Allstate Ins. Co.* (2000) 81 Cal.App.4th 1282, the appellate court held, rather broadly, that the genuine-dispute defense did not extend merely to legal issues but also applied to factual disputes such that an insurer did not act unreasonably if it relied upon an expert whose opinion disputed the insured's case. Since *Fraley,* insurers have routinely employed experts who offer so-called "low-ball" estimates of damages or whose opinions dispute the insureds' arguments as to the cause of a claimed loss.

The *Fraley* case essentially created an "expert safe-harbor" defense – a subcategory of the genuine-dispute defense – which meant that an insurer could effectively eliminate any liability for breach of the covenant of good faith and fair dealing so long as they retained an expert. Most judges and lawyers recognize and agree that insurers routinely use biased experts. Even the United States Supreme Court recognized this fact over 150 years ago, opining that "[e]xperience has shown that opposite opinions of persons professing to be experts, may be obtained to any amount." Insurers have always had an incentive to use an expert to support their denial, but after the *Fraley* decision insurers were incentivized to use biased experts on disputed or questionable matters to ensure the availability of the genuine-dispute defense.

A failed attempt at clawback: *Chateau Chamberay*

Recognizing that the *Fraley* decision was overly broad and would simply encourage corrupt practices, the Court of Appeal attempted to rein in its far-reaching and potentially disastrous impact. *Chateau Chamberay v. Associated Int'l Ins. Co.* (2001) 90 Cal.App.4th 335, carved out exceptions to the "expert safe-harbor" defense, opining that the genuine-dispute doctrine is unavailing if:

See Grossman & Dion, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
September 2017 Issue

(1) "(the insurer was guilty of misrepresenting the nature of the investigatory proceedings;
(2) the insurer's employees lied during the depositions or to the insured; (3) the insurer dishonestly selected its experts; (4) the insurer's experts were unreasonable; and (5) the insurer failed to conduct a thorough investigation." The court went on to explain that the list was not intended to be exclusive, adding the following additional sixth exception by way of footnote: "This list is certainly not intended to be exhaustive of the circumstances that may justify submission to a jury of an insurer's 'genuine dispute' defense to a claim of bad faith. Nor, we must also add, may an insurer insulate itself from liability for bad faith conduct by the simple expedient of hiring an expert for the purpose of manufacturing a 'genuine dispute.'"

But despite the court's restrictive recasting of the *Fraley* decision, the *Chateau Chamberay* biased-expert exceptions have largely gone ignored or have been unavailing to the insured. The "expert safe-harbor" strategy has now become a near absolute defense for the insurance industry and presents a license to engage in unsavory business practices. Since 2001, despite hundreds if not thousands of attempts, an insured has yet to demonstrate an expert's "bias" and prevail in a published or unpublished California appellate decision against an insurer asserting the "expert safe-harbor" defense to an action for bad faith denial of a claim.

As merely one example, in *Hodjat v. State Farm Mutual Automobile Ins. Co.* (2012) 211 Cal.App.4th 1, the court first noted that "summary judgment cannot be based on the 'genuine dispute' doctrine when the insurer dishonestly selected its experts, the experts were unreasonable or the insurer failed to conduct a thorough investigation." The court then went on to hold that "[w]hile these general propositions of law may be true, the Hodjats provide no explanation as to how they are true in this case. They do not name the expert who was purportedly dishonest or unreasonable or failed to thoroughly investigate their claim. They also do not describe what it was that he did not do or did wrong. In short, the Hodjats fail to apply the law to the facts of this case." A plethora of cases exist where, although the insured alleged bias, they failed to produce any evidence to support the allegations. Often, the insured simply relies upon the disparity in costs between their expert and the insurer's expert as a proxy to infer bias.

Three factors hamper plaintiffs

This lack of insureds' success may be attributable to three key factors. First, when a plaintiff's lawyer evaluates a case they are looking for failings in the insurance company's investigation. It's a logical step in the case evaluation: not only do these failings support allegations of bad faith, but they also defeat the genuine-dispute defense in the same stroke. Thus, the natural instinct for most plaintiff's attorneys is to immediately focus on the "failure to conduct a thorough investigation" exception set forth in *Chateau Chamberay*, and not the three exceptions dealing with expert bias.

Second, uncovering evidence revealing the lack of a thorough investigation simply follows from the case evaluation and management. There is no additional work involved for plaintiffs' counsel. Often the evidence is found merely in the claims file, which insurance companies reluctantly provide in discovery. On the other hand, evaluating and proving expert bias involves considerably more work and substantially more motions, as both insurers and their experts will resolutely fight and obstruct discovery to defend their practices.

And third, simply no guidance exists on what constitutes bias in the insurance arena. Although a few enterprising plaintiffs have attempted to argue bias, without any guidance, their attempts have invariably fallen far short of the mark. Notably, in one case, the appellate court succinctly captured the challenges of proving "expert bias." In overruling a demurrer, the appellate court highlighted that the complaint had sufficiently alleged that the insurer's expert was biased. However, while allowing the complaint to move forward, the appellate court nevertheless expressed "skepticism as to the nature of the competent and credible proof [that Plaintiff] will be able to offer in support of these allegations." The case was settled shortly after this decision. Thus, while courts have on occasion addressed allegations of bias in the insurance context, plaintiffs often don't provide sufficient evidence to support their allegations.

The "substantial relationship" test for bias

The crux of the challenge for insureds is the meaning of "bias" under *Chateau Chamberay*. As yet, no California appellate court has defined "bias" for purposes of the genuine-dispute defense, nor provides a blueprint for the evidence that must be adduced at trial. The field remains so muddled that it's not even clear whether a plaintiff must show "impression of bias," "appearance of bias," "unacceptable probability of actual bias," or "actual bias."

In general, "[b]ias is a term used in the 'common law of evidence' to describe the relationship between a party and a witness which might lead the witness to slant, unconsciously or otherwise, his testimony in favor of or against a party." In 1970, in an analogous insurance case dealing with the bias of a neutral third arbitrator, California adopted the rule set forth by the U.S. Supreme Court that an arbitrator is disqualified if there is an "impression of bias." The fact that no actual fraud or bias was charged or proved against the neutral umpire is immaterial. The neutral arbitrator must be above reproach.

For the past 15 years, California has applied – nearly universally – the impression of bias test, whether it is with respect to the disqualification of arbitrators, appraisers, attorneys, or judges. This has been markedly so in addressing the requirements of the independent appraiser under Insurance Code § 2071. Only on rare occasions, and for overriding reasons, have the courts deviated

See Grossman & Dion, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
September 2017 Issue

from applying the "impression of bias" rule.

More importantly, the courts have also failed to provide guidance as to which factors should be considered in evaluating bias in the insurance expert arena. The federal courts have openly lamented the failure of California courts to provide guidance on what evidence must be adduced at trial to demonstrate expert bias.

Analogous cases dealing with the "impression of bias" rule may be helpful if not yet dispositive. A leading case on expert bias is *Michael v. Aetna Life & Casualty Ins*. Co. (2001) 88 Cal.App.4th 925, which held that simply showing a substantial relationship (e.g., through number of cases and/or dollars paid), is sufficient to show bias. Judge Croskey concurred on this seminal opinion on bias – written a mere two months before he wrote *Chateau Chamberay* – in which the court held that bias may be shown by (1) substantial business dealings during the time of engagement existing between the expert and either the insurer or its representatives (including specifically its attorneys); or (2) substantial prior or continuing business relationship existing between the expert and either the insurer or its representatives, even if the business activity does not occur at the time of the expert's opinion. The *Michael* court distinguished relationships that are social in nature versus relationships imbued with a substantial financial interest, holding that "to create an impression of possible bias that therefore requires disclosure, a business relationship must be substantial and involve financial consideration."

Since *Michael*, the courts have held a relationship which contains a "pecuniary element" to a higher standard. In *Haas v. County of San Bernardino* (2002) 27 Cal.4th 1017, the California Supreme Court addressed at length the bias that infers when a relationship contains a pecuniary element, opining that "[o]f all the types of bias that can affect adjudication, pecuniary interest has long received the most unequivocal condemnation and the least forgiving scrutiny." The Court went on to cite extensively from several U.S. Supreme Court cases in rejecting the "actual bias" test in the context of relationship that contains a substantial pecuniary element, noting that the "presumption of impartiality" does not apply.

In the years since *Michael*, courts have also held that there is no time limit on the lookback, because the "substantial relationship" test is evaluated over the entire term of the relationship including an examination of well into double-digit years. However, in the context of insurance companies using biased experts to deny claims, no California state court has yet applied *Michael*, or any other case, to ascertain whether bias is present merely by reference to the metrics, or whether more is required.

Federal courts and the "actual bias" test: *Hangarter* and its progeny

While the "inference of bias" and the "substantial relationship" test set forth in *Michael* appears to be the applicable standard, the federal courts interpreting California law have enforced a much higher standard, imposing the requirement on the insured to show "actual bias." The seminal case on this issue is *Hangarter v. Provident Life & Accident Ins. Co.* (9th Cir. 2004) 373 F.3d 998, 1010. In *Hangarter* the Court addressed whether the insurance company could invoke the genuine-dispute defense when it relied upon a medical practitioner's opinion supporting its denial of disability benefits under a policy. The court held that the "[i]nsurer exhibited bias in selecting and retaining Dr. Swartz because Paul Revere used Dr. Swartz nineteen times from 1995 to 2000 .... Similarly, evidence showed that in thirteen out of thirteen cases involving claims for total disability, Dr. Swartz rejected the insured's claim that he or she was totally disabled."

While *Hangarter* merely highlighted the prior work of the medical practitioner, without ever explicitly stating that the plaintiff must demonstrate actual bias through other cases, the federal court cases that followed rejected the "inference of bias" test through dollars and numbers of claims and held that *Hangarter* required a showing of actual bias. In large part the enforcement of a higher standard has focused on the fact that it would be difficult to find an expert that doesn't perform work for the insurance industry. However, the failure of the industry to locate truly impartial experts should not mean that the insured has an insurmountable challenge in overcoming the biased expert. Rather, the burden should shift to the industry to cede the genuine-dispute defense and instead prove the soundness of its investigation apart from its reliance upon an expert.

Insurance companies prey on the unsuspecting insured

The *Chateau Chamberay* decision failed to rein in the use of biased experts. Consequently, the industry's practice of retaining experts has only proliferated in the years since. Now, multi-billion dollar public companies – such as Servicemaster Global Holdings Inc (NYSE:SERV) and Exponent (NASDAQ:EXPO) – exist to provide professional services and expert opinions to insurance companies. The average insured often unknowingly accommodates the insurance company's request to have a biased expert inspect the property. Moreover, the insurance carrier can also apply subtle coercion by invoking the policy's "cooperation" clause, either as a precursor to evaluating the claim or in conjunction with the policy's "right to sue" clause, without ever informing the insured of the relationship between the expert and the insurance company.

And woe is the more knowledgeable insured that objects to an inspection. An insured is obligated under the law to permit an inspection by the carrier's expert. As is typical for most homeowner's policies, the standard form of fire insurance policy in Insurance Code section 2071 specifically requires the insured to allow an inspection of the property by the insurance company. That same form contains a forfeiture of rights provision whereby the insured can lose the right to sue if the insured fails to comply with the policy. Unsurprisingly, insurance companies can and do coerce their

See Grossman & Dion, Next Page

Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
September 2017 Issue

insureds into allowing an inspection by their expert.

The appellate courts have also been supportive of this practice, announcing the general rule that, *in the absence of a reasonable excuse,* an insured's failure to comply with the insurance policy provisions regarding duties after loss and insurer requests will result in the forfeiture of coverage. However, the appellate courts have also emphasized that circumstances may exist when it would be unfair or unreasonable for an insurer to make a request, such as without first complying with an insured's request for information.

Demonstrating bias: *Colonial Life* and IPPA

The standard set forth in *Hangarter* poses a high hurdle for any insured in California. Although the insurance industry has been promoting the "actual bias" test for ferreting out expert bias, they also perpetuate the myth that the third-party claims files – for which an expert has performed services or provided an opinion – are subject to the rights and privacy of third parties, and thus not discoverable under the Information and Privacy Protection Act and the case law interpreting same. This creates a difficultly for the insured: the industry argues on the one hand that *Hangarter* requires an analysis of the third-party claims, but argues on the other hand that plaintiffs are precluded from viewing the claim files and performing the analysis because of the overriding privacy rights of third parties.

While the argument concerning the standard set by *Hangarter* is seemingly flawed based on a misapplication of California law by the federal courts, at least the federal courts have compensated of late by allowing the discovery of third-party claim files. A federal district court recently addressed the issue and ruled that neither the IPPA nor the case law prohibits the review of third-party claim files. In *Eastman v. Allstate Insurance Company* (S.D. Cal. July 15, 2016), the court found that the IPPA contains two exceptions which permit discovery. Specifically, the act permits disclosure in response to a judicial order, or when the disclosure is "otherwise permitted or required by law." The court specifically distinguished *Colonial Life* – the case typically relied upon by the insurance industry – noting that the 35-year-old case was misplaced because that case dealt with an entirely different section of the statute (Insurance Code § 791.13(a)), and then only addressed whether the particular notices complied with that particular section.

Moreover, even if *Colonial Life* required notices prior to contacting an insured, recent case law has also held that "opt-in" notices are no longer required, and that "opt-out" notices are more than adequate. Given the low return rate of opt-out notices, an alternative approach is to run concurrent courses: commencing claim file reviews while at the same time noticing the insureds to permit them to opt-out from contacts.

Conclusion

Insurance companies retaining biased experts to pretextually manufacture support for claim denials appears to be a growing problem. California is but one substantial earthquake or wildfire away from these same insurance practices and abuses rising once again to national prominence. The issue appears to be systemic, as insurance companies are not only outsourcing the claim denials to biased professionals, they are also continuing to adapt, as several are known to be re-outsourcing the outsourcing and thus creating a further shield to the practice. Until the courts provide guidance on exposing the practice, insurance companies will continue to exploit the statutory and case law vacuum. Combating the issue will require a monumental investment of time and resources by plaintiffs' counsel to expose the biased experts through additional discovery. It is an effort we incorporate into our cases and an effort worth undertaking.

Evangeline Fisher Grossman has practiced plaintiffs' insurance bad faith law for 23 years. She is the managing partner of Evangeline Fisher Grossman Law *in Claremont, California. She has handled thousands of insurance bad-faith property cases. She is a former partner of Shernoff Bidart Echeverria, LLP and was a finalist for Trial Lawyer of the Year for the Consumer Attorneys of California in 2014. She is a graduate of Occidental College and Santa Clara Law School. She can be contacted at egrossman@efglawyer.com.*

Christopher Dion is an attorney of 30 years with a broad-based media, finance and insurance background. He most recently served as Vice President of Claims for Lockton Insurance Brokers, and is currently working on exposing the "expert safe-harbor" issues in a case filed in Los Angeles Superior Court. He is a graduate of University of California, Los Angeles and University of California, San Francisco (Hastings College of the Law).