BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
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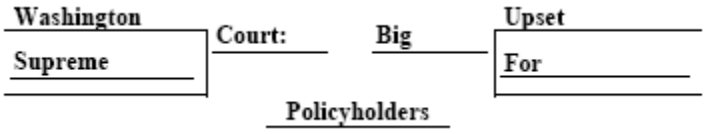


**High Court Adopts Lay-up Standard for Bad Faith**

When policyholders believe that their insurer has inappropriately denied a claim, they will often threaten to bring an action for bad faith. When my 3 year old daughter won't put away her toys, or stay in bed or pretty much do anything I say, I'll often threaten that we won't go here or there unless she does a better job of listening. In the end, policyholders rarely pursue their bad faith claims, yet alone secure a damage award and I rarely follow through on my threats. For policyholders, that's because the high burden for establishing bad faith makes it difficult for them to do so. For me, the place that I'm threatening not to take my daughter is usually one where I want to go myself.

When it comes to establishing bad faith, on account of an insurer's wrongful denial of a claim, it is easier said than done. The reason being that the standard for doing so is very high. While the standards vary by state, many require that the insurer's conduct be such things as dishonest, malicious or reckless or that the insurer knowingly disregarded the fact that it had no reasonable basis for denying the insured's claim.

That's a steep hill for a policyholder to climb. In other words, if the issue was a novel one, and the insurer had to make its determination on a clean slate, there was likely support in the policy language for its decision. If the issue was one that is the subject of a body of case law, there was likely a judicial opinion, or a couple, that supported the insurer's determination.

So even if an insurer's denial of a claim is ultimately determined by a court to have been incorrect, surely the insurer's conduct in reaching that decision was not dishonest or reckless. The insurer was wrong and it will now be made to place the policyholder in the position it would have been if the insurer had not been. This means that the insurer may have to provide coverage for damages and pay its insured's defense costs and perhaps pay its insured's attorney's fees. But damages for bad faith? Not happening.

Now welcome to Washington – where on Thursday its Supreme Court seemingly added bad faith damages to the policyholder's list of entitlements for an insurer's denial of a claim that was wrongful – *but without anything more*.

The court's how-do-you-like-them-apples decision shakes bad faith to its core and has planted the seeds for a host of problems for insurer's going forward. Policyholder counsel must have bruised skin from pinching themselves so many times to be sure that it is not a dream.

This week's decision in *American Best Food, Inc. v. ALEA London, Inc*. involved the applicability of an Assault and Battery Exclusion to a claim for damages sought by a party injured in a bar fight. The issue was whether the A&B exclusion applied because the plaintiff in the underlying claim alleged that his injuries were exacerbated on account of the bar's security guards "dumping him on the sidewalk" after he was shot 9 times. [And I thought Lenny's Tavern was a rough place.]

The insurer argued that the A&B exclusion applied because, based on the "arising out of" aspect of the exclusion, which the insurer interpreted as a "but for" test, "absent the assault, [the underlying plaintiff] would have no cause of action against Café Arizona and thus, his entire claim, including his claim for any injuries sustained when club security guards allegedly dumped him on the sidewalk on orders of the club owner, is excluded under the policy." *American Best* at 6.

In support of its decision, the insurer relied on a Washington appeals court decision from 2000 that applied an A&B exclusion broadly. However, the Supreme Court noted that the decision relied on by the insurer involved "pre-assault" negligence and the issue before it involved "post-assault" negligence. *Id.* at 7.

The policyholder's counsel had advised the insurer of a Texas federal court decision that was admittedly on point – a tavern owner's failure to render aid to an injured patron was not excluded by an Assault and Battery exclusion. *Id.* at 3. The Supreme Court also noted, and provided examples that "[m]any states have found a preassault/postassault distinction in analyzing 'assault and battery' exclusions." *Id.* at 8.

The Supreme Court, following an examination of this A&B case law, concluded that the insurer had breached its duty to defend:

> Alea contends that persuasive out-of-state precedent should not trump binding in-state law. We agree. However, as the Court of Appeals noted, Washington courts have yet to consider the factual scenario before us today. Evaluation of out-of-state cases was appropriate in deciding which rule to apply. The lack of any Washington case directly on point and a recognized distinction between preassault and postassault negligence in other states presented a legal uncertainty with regard to Alea's duty. Because any uncertainty works in favor of providing a defense to an insured, Ale's duty to defend arose when Dorsey brought suit against Café Arizona.

*Id.* at 9.

Having concluded that the policy afforded coverage for post-assault negligence, to the extent it caused or enhanced the underlying plaintiff's injuries, the court turned to the consideration of bad faith and concluded as follows:

> It cannot be said that the insurer did not put its own interest ahead of its insured when it denied a defense based on an arguable legal interpretation of its own policy. Alea failed to follow well established Washington State law giving the insured the benefit of any doubt as to the duty to defend and failed to avail itself of legal options such as proceeding under a reservation of rights or seeking declaratory relief. Alea's failure to defend based upon a questionable interpretation of law was unreasonable and Alea acted in bad faith as a matter of law.

*Id.* at 15. (emphasis added).

The decision in *American Best* was 5-4 and the dissenting justices did not go quietly. Out the outset, the dissent agreed with the majority's adoption of a new rule of Washington law that post-assault negligence does not fall under an insurance policy's "arising out of" A&B exclusion, and, therefore, the insurer did in fact breach its duty to defend. "This, however, does not resolve the question of whether Alea acted in *bad faith* when it refused to defend Café Arizona. The standard for finding that an insurer has breached its duty of good faith is a different matter entirely." *Dissent* at 4. (emphasis in original).

The dissent noted that the insurer relied on "well-established" Washington case law to reach its decision. And while those cases may have been "narrowly distinguishable," because the post-assault issue was one of first impression, the dissent could not "conclude that [the insurer's] contrary determination, although incorrect, was unreasonable, frivolous, or unfounded in light of the existing case law." *Dissent* at 7.

The dissent further criticized the majority's opinion:

> In finding that Alea breached its duty of good faith, the majority is either relying on its conclusory statement [that failure to defend based upon a questionable interpretation of law is unreasonable] or presuming that a breach of the duty to defend is per se evidence of a breach of the duty of good faith. The former is unfounded while the latter is contrary to our precedent, which has held that breach of the duty to defend is insufficient to show the tort of bad faith. Further, the result is an undesirable outcome, as bad faith determinations should be reserved for more culpable conduct.

*Dissent* at 9. [The majority disputed the dissent's suggestion that it was presuming that a breach of the duty to defend is per se bad faith. *Majority* at 14, n.5.]

There is a lot that can be said about this week's decision in *American Best*:

Having looked not too long ago at the bad faith standard in all 50 states, there appears to be nothing that sets the bar this low for policyholders to prevail on a bad faith claim on account of an insurer's wrongful denial of a claim.

Could the decision influence other states? Probably not. It was a 5-4 decision and it will likely be seen as inconsistent with most states' established duty to defend standards. [Although that's what the dissent though.]

The biggest concern for the dissent, and likely for insurer's with Washington claims going forward, is the majority's statement that the insurer "put its own interest ahead of its insured" and failed to give "the insured the benefit of any doubt." As the dissent correctly noted: "These statements will always apply where an insurer relies on a questionable interpretation of law in its favor." *Dissent* at 8.

Therein lies the real impact of the decision. Coverage determinations are frequently not black and white. So much of handling claims involves gray ones – where policy language and/or case law is not directly on point. But that's not to say that an insurer can not rely on such policy language or case law to deny coverage. Coverage case law is constantly evolving. New facts and policy language are examined by the court, and applied to any existing case law, and the court decides which party's argument is more persuasive. Isn't that how the entire judicial system works? If the insurer was wrong, it owes coverage and any attendant consequences. But *bad faith*?

But now there is a new dynamic for insurers with Washington claims. Expect policyholders to use the threat of bad faith against insurers in every case where the coverage determination is not cut and dry – which is a lot of them.

A copy of the majority and dissenting opinions is *American Best* can be accessed here:

http://www.courts.wa.gov/opinions/pdf/807531.opn.pdf

http://www.courts.wa.gov/opinions/pdf/807531.jp1.pdf

Please let me know if you have any questions.

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