

# Duty to Defend Bad Faith Issues

2020 Annual Meeting

September 24, 2020

Robert Allen, Linda Dedman,  
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# Duty to Defend and Bad Faith

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- Choice of Law Analysis/Selection of Forum
  - Differences between State and Federal Court
  - Results Differ Significantly Depending on the Forum
  - Eight Corner Rule
  - Extrinsic Evidence Allowed to Grant a Defense
  - Extrinsic Evidence Allowed to Deny a Defense

# Bad Faith

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- Common Law
- Statutory
- Different Standards of Conduct



# Duty to Defend and Bad Faith

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- Defense is allegedly so substandard as to be bad Faith
  - Illinois cases: close but no bad faith finding
    - But poor defense breached the defense duty with all that entails for estoppel in Illinois
    - *See i.e., Delatorre v. Safeway Insurance Co.*, 989 N.E.2d 268 (Ill. App. Ct. 2013)(insurer's inactivity after accepting defense resulted in liability for default judgment including amounts in excess of policy limits).
  - Texas case: pending
    - *In re Farmers Texas County Mutual Insurance Co.*, 604 S.W. 2nd 421 (Tex. App.—San Antonio 2019).



# Defenses to Bad Faith Claims

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- Genuine Dispute Doctrine / Fairly Debatable Doctrine
- Reasonable and Timely Investigation of Claim
- Insured's Failure to Cooperate / breach of contract
- Statute of Limitations
- Insured's Failure to Mitigate
- Absence of Coverage
- Assignment of Claim to Third Party
- Advice of Counsel



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The Code Word is...

**WASH**

# Breach of the Duty to Defend

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- Contractual Remedies
  - Out of Pocket Expenses (What Rates Must Insurer Pay)
  - Consequential Damages
  - Attorneys Fees, what rates must the insurer pay, *Taco Bell Corp. v. Continental Casualty Co.*, 388 F.3d 1069 (7th Cir. 2004).
  - Statutory Interest Penalties (e.g., Tex. Ins. Code 542.051)

# Breach of the Duty to Defend

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- Extracontractual Remedies
  - Damages in Excess of Policy Limits
  - Treble Damages
  - Punitive Damages

# Duty to Defend and Bad Faith

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- Coverage by Estoppel resulting from breach of duty to defend. Examples are:
  - Illinois
  - Wisconsin
- Can lead to outcomes as adverse as bad faith damages
- See examples of liability for misrepresentations or inaction of insurer: *Liberty Mut. Fire Insurance Co. v. Canal Insurance Co.*, 177 F.3d 326 (5th Cir. 1999); *Delatorre v. Safeway Insurance Co.*, 989 N.E.2d 268 (Ill. App. Ct. 2013).
- See examples of coverage by estoppel for wrongful withdrawal of defense: *Pershing Park Villas Homeowners Ass'n v. United Pacific Insurance Co.*, 219 F.3d 895 (9th Cir. 2000); *Pacific Indemnity Co. v. Acel Delivery Service, Inc.*, 485 F.2d 1169 (5th Cir. 1973); *Beckwith Machinery Co. v. Travelers Indemnity Co.*, 638 F.Supp. 1179 (W.D. Pa. 1986).

# Defense Under Reservation

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- Defense by Panel Counsel
- Insurer's Responsibility for Defense Counsel Malpractice
- Insurer's Responsibility for Excess Judgments

# Defense Under Reservation

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- Right to Independent Counsel
- What Constitutes a Material Conflict
- Excess Exposure for Defense Handled by Independent Counsel
- How to Determine Reasonable Rates

# When is a Policyholder Entitled to Independent Counsel

- No Independent Counsel Right
  - But defense may be controlled by policyholder because defense counsel owes allegiance to policyholder alone
- Existence of a Conflict of Interest
  - Statutory
  - Common law

# When is a Policyholder Entitled to Independent Counsel

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- What Reservation of Rights Result in a Conflict of Interest?
  - Intentional Acts
  - Facts at Issue in Underlying Lawsuit
  - Characteristics of Underlying Injury, Damage or Circumstance
  - Damages in Excess of Limits
  - Punitive Damages
  - Cross-claims
  - Defense Strategy (e.g. Special vs General Verdict Form)

## Bad Faith Ramifications for Refusal of Independent Counsel

- Part of Duty to Defend
- Breach of Statutory Obligation
- Insurer's Liability for Inadequate Defense

# Defense of Claims Within Self-Insured Retention

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- Defense Expenses Erode SIR
  - May a policyholder erode the SIR with defense expenses at rates in excess of rates commonly paid by the insurer?
  - Must the Insurer Continue the Defense Using the Policyholder's Selected Counsel Once the SIR is Exhausted?
  - Who controls the defense following exhaustion of the SIR?
  - Burn Rate

# Declaratory Judgment Actions

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# Declaratory Judgment Actions

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- Most Common Method to Litigate Defense Obligations
  - Bad Faith for Filing Declaratory Judgment Action
  - Declaratory Judgment Action as a Defense to Bad Faith Allegations

# Questions?

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