

A LIABILITY INSURER’S BREACH OF THE DUTY TO DEFEND AND THE OFTEN ERRONEOUS CONSEQUENCE OF EXTRACTIONAL LIABILITY

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I. INTRODUCTION

Liability insurance touches the business, occupation or profession, and personal life of almost everyone in the United States. Businesses are insured under commercial general liability (“CGL”) insurance policies, cyber liability policies, directors’ and officers’ (“D&O”) liability policies, employment practices liability insurance policies, and excess or umbrella policies. Professionals and the firms, groups, and institutions in which they practice maintain errors and omissions (“E&O”) insurance coverage. Individuals receive liability coverage under homeowners’ and personal auto policies. And this list is by no means exhaustive.

Under most liability insurance policies, the insurance company has an express contractual duty to (1) defend the insured in litigation and equivalent proceedings;¹ and (2) indemnify the insured against covered judgments up to the policy’s liability limit. In some cases, the insurer’s implied duty of good faith and fair dealing may obligate it to settle a claim or lawsuit against the insured for an amount within its policy limits.² Of these duties, the duty to defend is commonly said to be the broadest.³ “The duty to defend hinges on the nature, not

¹ See, e.g., Ins. Servs. Office, Inc., Commercial General Liability Coverage Form (CG 00 01 04 13), at 1 (2012) (providing that the insurance company “will have the right and duty to defend the insured against any ‘suit’” seeking covered damages) (on file with the author); Ins. Servs. Office, Inc., Homeowners 3 – Special Form (HO 00 03 05 11), at 17 (2010) (stating that “[i]f a claim is made or a suit is brought against an ‘insured’ for damages because of ‘bodily injury’ or ‘property damage’ caused by an ‘occurrence’ to which [the policy] applies,” the insurer will “[p]rovide a defense at [its] expense by counsel of [its] choice, even if the suit is groundless, false or fraudulent”) (on file with the author). While a standard liability insurance policy obligates the insurer to defend the insured against “suits” seeking covered damages and insurers routinely defend insureds in civil litigation, courts have held various other actions to be “the functional equivalent of a suit.” 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSURED § 4:1, at 4-4 to -5 (6th ed. 2013). These matters include administrative proceedings and arbitrations. *Id.* § 4:1, at 4-5 n.4 (collecting cases).

² The implied duty of good faith and fair dealing fundamentally requires that neither party to a contract do anything to injure the other party’s right to receive the benefits of the agreement. *Burnett v. Gov’t Emps. Ins. Co.*, 389 P.3d 27, 31 (Alaska 2017) (quoting *Jackson v. Am. Equity Ins. Co.*, 90 P.3d 136, 142 (Alaska 2004)); *Thornton v. Am. Interstate Ins. Co.*, 897 N.W.2d 445, 461 (Iowa 2017) (quoting *Johnson v. Farm Bureau Mut. Ins. Co.*, 533 N.W.2d 203, 207 (Iowa 1995)); *Manu v. GEICO Cas. Co.*, 798 S.E.2d 598, 606 (Va. 2017).

³ See, e.g., *Scout, L.L.C. v. Truck Ins. Exch.*, 434 P.3d 197, 202 (Idaho 2019) (describing an insurer’s duty to defend as “much broader” than its duty to indemnify an insured); *U-Haul Co. of Mo. v. Carter*, 567 S.W.3d 680, 685 (Mo. Ct. App. 2019) (“It is well-settled that an insurer’s duty to defend is broader than its duty to indemnify.”); *State ex rel. Nationwide Mut. Ins. Co. v. Wilson*, 778 S.E.2d 677, 682 (W. Va. 2015) (“By contrast, an insurer’s duty to provide its insured a defense is broader than the duty to indemnify.”); *Steadfast Ins. Co. v. Greenwich Ins. Co.*, 922 N.W.2d 71, 79 (Wis. 2019) (“[T]he duty to defend is broader than the duty to indemnify.”). Courts’ statements that an insurer’s duty to defend is broader than its duty to indemnify should not be understood to mean that a liability insurance policy’s coverage is broader with respect to the duty to defend than it is with respect to the duty to indemnify. Both duties flow from the policy’s insuring agreement;

the merits, of the plaintiff's claim."⁴ The duty to defend attaches where there is merely the potential for coverage,⁵ that is, where the plaintiff's claims or causes of action allege facts that potentially obligate the insurer to indemnify the insured if liability is ultimately established.⁶ For that matter, the duty to defend obligates the insurer to defend the entire lawsuit if the plaintiff pleads even one potentially covered claim or cause of action.⁷ In deciding whether an insurer owes a duty to defend, courts resolve any ambiguities or doubts in favor of the insured.⁸

Broad though it may be, the insurer's duty to defend is not limitless. "The duty to defend does not attach where, as a matter of law, there is no basis on which the insurer may be held liable for indemnification."⁹ Perhaps more simply stated, an insurer owes no duty to defend where there is no possibility of coverage.¹⁰

An insurer must decide whether it has a duty to defend its insured at the outset of the litigation.¹¹ The insurer must make that decision within a reasonable

their differences are attributable to their conditions. The duty to indemnify exists as soon as the contract is formed, but it is not triggered until the insured's liability is established. The duty to defend is not similarly conditioned: it exists as soon as a claim potentially within coverage is made, regardless of whether the insured is ultimately held liable. Because the duty to indemnify is conditioned on the insured's liability and the duty to defend is not, the duty to defend is implicated in more cases; however, this does not alter the essential relationship between the insurer's duty to defend and coverage under the policy. ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 692–93 (6th ed. 2018).

⁴ Great Lakes Beverages, L.L.C. v. Wochinski, 892 N.W.2d 333, 338 (Wis. Ct. App. 2017).

⁵ Hartford Cas. Ins. Co. v. J.R. Mktg., L.L.C., 353 P.3d 319, 325 (Cal. 2015); Harlor v. Amica Mut. Ins. Co., 150 A.3d 793, 799 (Me. 2016) (quoting Travelers Indem. Co. v. Dingwell, 414 A.2d 220, 226 (Me. 1980)); Kruger-Willis v. Hoffenburg, 393 P.3d 844, 848 (Wash. Ct. App. 2017).

⁶ JERRY & RICHMOND, *supra* note 3, at 696.

⁷ Teufel v. Am. Family Mut. Ins. Co., 419 P.3d 546, 549 (Ariz. 2018); Mount Vernon Fire Ins. Co. v. Visionaid, Inc., 76 N.E.3d 204, 210 (Mass. 2017); *Steadfast Ins. Co.*, 922 N.W.2d at 79.

⁸ Clarke Co., Ltd. v. Am. Family Mut. Ins. Co., 914 F.3d 588, 591 (8th Cir. 2019) (applying Iowa law); Travelers Prop. & Cas. Co. of Am. v. Actavis, Inc., 225 Cal. Rptr. 3d 5, 15 (Ct. App. 2017); Am. Access Cas. Co. v. Novit, 105 N.E.3d 839, 845 (Ill. App. Ct. 2018); Todd v. Vt. Mut. Ins. Co., 137 A.3d 1115, 1120 (N.H. 2016); Grigg v. Aarrowcast, Inc., 909 N.W.2d 183, 191 (Wis. Ct. App. 2018).

⁹ Zurich Am. Ins. Co. v. Ace Am. Ins. Co., 86 N.Y.S.3d 468, 469 (App. Div. 2018).

¹⁰ Mau v. Twin City Fire Ins. Co., 910 F.3d 388, 390–91 (8th Cir. 2018) (quoting Schultze v. Cont'l Ins. Co., 619 N.W.2d 510, 513 (N.D. 2000)); All Green Elec., Inc. v. Sec. Nat'l Ins. Co., 231 Cal. Rptr. 3d 449, 454 (Ct. App. 2018); Spencer v. Hartford Cas., 556 S.W.3d 679, 683 (Mo. Ct. App. 2018).

¹¹ See Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc., 2 A.3d 526, 541–42 (Pa. 2010) ("[W]hether a complaint raises a claim against an insured that is potentially covered is a question to be answered by the insurer in the first instance Although the question of whether the claim is covered (and therefore triggers the insurer's duty to defend) may be difficult, it is the insurer's duty to make that decision.").

time after the insured requests a defense.¹² Depending on the jurisdiction, the insurer will decide whether to defend the insured based either on the facts alleged in the plaintiff's complaint or petition, or on a combination of the facts alleged in the plaintiff's complaint or petition and any extrinsic evidence that indicates the potential for coverage.¹³ If coverage is clear, the insurer will accept the insured's defense and, ultimately, indemnify the insured up to the liability limits of its policy if necessary. If the insurer's analysis of the facts presented at the outset of the litigation suggests that it may have a duty to indemnify the insured but that its duty to do so is uncertain, the insurer typically will defend the insured under a reservation of rights.¹⁴ Finally, it may be that the insurer will be unable to ascertain any possible basis for coverage and consequently decline to defend the insured. If, in this final scenario, the insurer is for some reason wrong about the potential for coverage, it will have breached its duty to defend the insured.¹⁵ Then, like any party that breaches a contract, it will potentially be liable for the insured's damages caused by the breach.¹⁶ But what are those damages? If the

¹² See *Rushforth Constr. Co. v. Wesco Ins. Co.*, No. C17-1063-JCC, 2018 WL 1610222, at *2 (W.D. Wash. Apr. 3, 2018) ("An insurer may breach its duty to defend by failing to respond to an insured's tender in a reasonably timely manner.").

¹³ There are two approaches to determining an insurer's duty to defend. Under the "four corners" or "eight corners" approach, the factual allegations in the plaintiff's complaint or petition are compared with the policy, and the insurer owes a defense only if those allegations potentially implicate the insurer's duty to indemnify the insured. *Lupu v. Loan City, L.L.C.*, 903 F.3d 382, 389–92 (3d Cir. 2018) (applying Pennsylvania law); *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 307 (Tex. 2006). Under this approach, facts outside the pleadings are not material to the determination of the insurer's duty to defend. *Lupu*, 903 F.3d at 390–91; *GuideOne*, 197 S.W.3d at 307. In contrast, courts employing an "extrinsic evidence" approach hold that an insurer must look beyond the pleadings and consider any facts brought to its attention or any facts that it reasonably could discover in determining whether it has a duty to defend. See, e.g., *Att'y's Liab. Prot. Soc'y, Inc. v. Ingaldson Fitzgerald, P.C.*, 370 P.3d 1101, 1111–12 (Alaska 2016) ("[T]he duty to defend attaches, if at all, on the basis of the complaint and known or reasonably ascertainable facts at the time of the complaint." (footnote omitted)); *Allen v. Bryers*, 512 S.W.3d 17, 31 (Mo. 2016) ("The duty to defend is determined by comparing the insurance policy language with facts: '(1) alleged in the petition; (2) the insurer knows at the outset of the case; or (3) that are reasonably apparent to the insurer at the outset of the case.'" (quoting *Allen v. Cont'l W. Ins. Co.*, 436 S.W.3d 548, 553 (Mo. 2014))). For courts following the extrinsic evidence approach, the allegations in the plaintiff's petition or complaint are merely the starting point in analyzing the insurer's duty to defend.

¹⁴ See *JERRY & RICHMOND*, *supra* note 3, at 705–07 (explaining reservations of rights).

¹⁵ On the other hand, if the insurer's coverage determination is correct, then there is no breach of the duty to defend. *Blake v. Nationwide Ins. Co.*, 904 A.2d 1071, 1076 (Vt. 2006).

¹⁶ RESTATEMENT (SECOND) OF CONTRACTS § 347 (AM. LAW INST. 2005); see generally Colin Quinn & Brendan Quinn, *Awarding Damages for a Breach of Contract: Direct or Consequential?*, J. KAN. B. ASS'N, Oct. 2017, at 20, 21 ("While numerous types of damages can result from a breach [of contract], they are generally classified into two categories. The first category, direct damages, are those which flow directly from the breach itself. The second category, consequential damages, refer to the economic harm that is beyond the immediate scope of the contract.").

insurer breaches its duty to defend and the insured enters into a settlement in which it consents to a judgment in excess of the policy limits,¹⁷ surrenders a default judgment in excess of the policy limits, or tries the case with its own lawyers and suffers a judgment in excess of the policy limits, do the insured's consequential damages recoverable for the breach include the full amount of the excess judgment? In other words, does an insurance company's simple breach of its duty to defend expose it to extracontractual liability?

The question of whether an insurer's breach of its duty to defend should expose it to extracontractual liability is an enormously important one from a financial standpoint. The sums at stake in cases in which the insurer allegedly breached its duty to defend tend to be substantial. Unfortunately, courts do answer the question consistently or—all too often—even correctly. The question was answered most recently by the Nevada Supreme Court in its December 2018 decision in *Century Surety Co. v. Andrew*,¹⁸ in which the court held that “even in the absence of bad faith, the insurer may be liable for a judgment that exceeds the policy limits if the judgment is consequential to the insurer's breach.”¹⁹ Under the *Andrew* approach, an insurer that declines to defend its insured assumes the risk of extracontractual liability.²⁰ As the *Andrew* court succinctly summarized matters, an insurer “refuses to defend at its peril.”²¹ Other courts have made similarly grim statements about the possible consequences of an insurer's innocent misjudgment of its duty to defend.²²

Commentators immediately heralded the *Andrew* decision as a “potent weapon” and “powerful tool” for insureds.²³ Some policyholder lawyers

¹⁷ For explanations of consent judgments, see Douglas R. Richmond, *Consent Judgments and the Taint of Bad Faith, Fraud, and Collusion*, NEW APPLEMAN CURRENT CRITICAL ISSUES IN INS. LAW, Winter 2018, at 1, 1–2; Jill B. Berkeley & Seth D. Lamden, *To the Policy Limits and Beyond*, THE BRIEF, Spring 2018, at 37, 42–43; Jeffrey N. Labovitch & Cody S. Moon, *What Insurers and Their Counsel Should Know About Consent Judgments*, FOR DEF., May 2015, at 34–37; Douglas R. Richmond, *The Consent Judgment Quandary of Insurance Law*, 48 TORT TRIAL & INS. PRAC. L.J. 538, 541–45 (2013).

¹⁸ 432 P.3d 180 (Nev. 2018).

¹⁹ *Id.* at 186.

²⁰ *See id.* (quoting *Hamlin v. Hartford Accident & Indem. Co.*, 86 F.3d 93, 94 (7th Cir. 1996)).

²¹ *Id.*

²² *See, e.g., Tidyman's Mgmt. Servs. Inc. v. Davis (Tidyman's D)*, 330 P.3d 1139, 1149 (Mont. 2014) (“In other words, where an insurer refuses to defend its insured, it does so at its peril.”); *Dove v. State Farm Fire & Cas. Co.*, 399 P.3d 400, 405 (N.M. Ct. App. 2017) (“[A]n insurer who refuses to defend . . . without seeking a judicial determination that the alleged insured is not covered under the policy or without a voluntary waiver from the insured does so at its peril.” (citations omitted)).

²³ Jeff Sistrunk, *Nev. Defense Breach Ruling to Tee Up Damages Battles*, LAW360 (Dec. 18, 2018), <https://www.law360.com/articles/1112641/nev-defense-breach-ruling-to-tee-up-damages-battles> (saying that the Nevada Supreme Court's decision in *Andrew* “gave policyholders a potent weapon”); Payne & Fears, *Victory for Policyholders—An Insurer's Breach of the Duty to Defend Opens Up Policy Limits*, JD SUPRA (Dec. 17, 2018), <https://www.jdsupra.com/legalnews/victory->

apparently emboldened by *Andrew* even appeared to go so far as to suggest that lawyers representing insureds should scheme at the outset of a case either to induce the insurer to breach its duty to defend or to maximize the insured's damages in the event of a breach.²⁴

Although the *Andrew* court admirably qualified its holding by stating that an insured seeking to hold an insurer liable for an excess judgment must prove that the insurer's breach of its duty to defend caused the excess judgment and that she took all reasonable means to protect herself and mitigate her damages,²⁵ the court nevertheless erred. With rare exception, an insurer's simple breach of the duty to defend should not expose it to extracontractual liability. To the contrary, the insured's damages should be capped at the policy limits plus the insured's defense costs, if any. Extracontractual liability for breach of the duty to defend should require an act of bad faith by the insurer or some other extraordinary circumstance. Indeed, that is the majority rule,²⁶ although courts all too often hold that an insurer's breach of its duty to defend makes it liable for the full amount of any subsequent judgment under basic contract damages theory, and courts in a number of states have yet to consider insurers' possible extracontractual liability for breach of the duty to defend.²⁷ This Article explains the minority rule's infirmities and the correctness of the majority rule in the hope that courts that have not adopted the majority rule will do so when presented with the opportunity, and that those that follow the minority rule will reconsider their positions.

Looking ahead, Part II discusses the minority approach, under which an insurer's mistaken breach of its duty to defend may expose it to extracontractual liability; bad faith is not required for the insurer to be liable beyond its policy limits. It begins by explaining the many serious flaws in the minority approach. After doing so, it examines the *Andrew* case in detail. In addition to being the

for-policyholders-an-insurer-s-53492/ (describing the *Andrew* decision as "another powerful tool that a policyholder may use to combat insurance companies").

²⁴ See Payne & Fears, *supra* note 23 ("Careful planning by a policyholder and insurance counsel from the outset of a case can dramatically increase the insurance company's potential liabilities, opening up the door for earlier settlements and better results.").

²⁵ *Andrew*, 432 P.3d at 186 (quoting *Thomas v. W. World Ins. Co.*, 343 So. 2d 1298, 1303 (Fla. Dist. Ct. App. 1977)).

²⁶ *Id.* at 184 (quoting *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 201 (Cal. 1958)).

²⁷ In an amicus curiae brief filed with the Nevada Supreme Court in *Andrew*, the Federation of Defense & Corporate Counsel asserted that ten states had direct precedent capping an insurer's liability at its policy limits, cases in four states suggested that those states would adopt the policy limits rule, federal courts interpreting or predicting the law of three additional states had adopted or supported the policy limits rule, courts in eight states allowed extracontractual liability, and 25 states had not addressed the question. Brief for the Fed'n of Defense & Corp. Counsel as Amicus Curiae Supporting Appellant, at *2–20, *Century Sur. Co. v. Andrew*, 432 P.3d 180 (Nev. 2018) (Case No. 73756), 2017 WL 9940103.

most recent state supreme court case to follow the minority approach, *Andrew* illustrates some of the problems with that approach.

Part III then discusses the majority approach, which, again, holds that an insurer's simple breach of the duty to defend does not create excess liability; rather, the insurer's damages top out at the policy limits plus the insured's defense costs, if any. In examining the majority approach, Part III dives deeply into its exceptions. As this Part explains, an insurer may suffer extracontractual liability for breaching its duty to defend if the breach is coupled with an unreasonable refusal to settle the claim or lawsuit against the insured within policy limits or the breach rises to the level of bad faith based on a test that tracks the two-part test commonly used for first-party bad faith. Furthermore, an insurer may face extracontractual liability if it leads an insured to believe that it will provide a defense but ultimately does not, and the insured's detrimental reliance on the insurer's promise to defend results in a default judgment that exceeds policy limits. Finally, some scholars have asserted that another possible exception to the general rule that an insurer's breach of its duty to defend should not produce extracontractual liability may be found where the insured is unable to afford a lawyer and suffers a default judgment that exceeds policy limits as a result. This final exception, however, is arguable.

II. THE MINORITY RULE ALLOWING EXTRACTIONAL LIABILITY

A. *The Minority Rule Misapprehends Contract Damages in Insurance Law*

Again, various courts have held or stated that an insurer that breaches its duty to defend is liable for the full amount of any subsequent judgment—including amounts in excess of the policy limits.²⁸ These courts reason that an

²⁸ See, e.g., *Liberty Mut. Ins. Co. v. Metro. Life Ins. Co.*, 260 F.3d 54, 63 (1st Cir. 2001) (“[T]he general rule under Massachusetts law is that if the insurer fails to defend the lawsuit, it is liable for all defense costs and (assuming policy coverage) the entire resulting judgment or settlement, unless liability can be allocated among covered and uncovered claims.”); *Newman v. United Fire & Cas. Co.*, 995 F. Supp. 2d 1125, 1133 (D. Mont. 2014) (“Under both Utah and Montana law, the consequence of an insurer’s failure to defend are the same: the insurer is responsible for any judgments entered below.”); *McGrath v. Everest Nat’l Ins. Co.*, 668 F. Supp. 2d 1085, 1107–09 (N.D. Ind. 2009) (applying Indiana law); *Sauer v. Home Indem. Co.*, 841 P.2d 176, 184 (Alaska 1992) (“[A]n insurance company which wrongfully refuses to defend is liable for the judgment which ensues even though the facts may ultimately demonstrate that no indemnity is due.”); *Atlanta Cas. Ins. Co. v. Gardenhire*, 545 S.E.2d 182, 184 (Ga. Ct. App. 2001) (“[W]here an insurance company fails to offer a defense, it may be liable to its insured beyond the policy limits to the full amount of the judgment.”); *Cincinnati Ins. Co. v. Vance*, 730 S.W.2d 521, 523 (Ky. 1987) (“[I]f the insurer has elected not to provide a defense wrongfully or erroneously because it is later determined that the policy provided coverage, the insurer then would have breached the terms of its policy and the aggrieved party then would be entitled to recover all damages naturally flowing from the breach irrespective of policy limits.”); *Tidyman’s I*, 330 P.3d 1139, 1150 (Mont. 2014) (“[A]n insurer who breaches the duty to defend is liable for the full amount of the judgment, including amounts in excess of policy limits.”); *Andrew*, 432 P.3d at 182 (“We conclude that an

insurer's breach of its duty to defend entitles the insured to "recover all damages naturally flowing from the breach," which include a judgment that exceeds the breaching insurer's policy limits.²⁹ This is said to be a fundamental breach of contract damages analysis.³⁰

In fact, an insurer's alleged extracontractual liability does not flow naturally from a simple breach of the duty to defend. This is first because any lawyer the insured hires to defend it will presumably provide the same quality of representation as the lawyer the insurer would have appointed to defend the insured had the insurer properly accepted the defense.³¹ Accordingly, the amount of any judgment against the insured should be the same or nearly so, regardless of who provided the insured's defense.³² Alternatively, the plaintiff's case against the insured may be so strong that even a vigorous defense provided by the insurer would not have defeated liability or held the insured's damages within policy limits.³³ If so, the insurer's acceptance of the defense would not have

insurer's liability where it breaches its contractual duty to defend is not capped at the policy limits plus the insured's defense costs, and instead, an insurer may be liable for any consequential damages caused by its breach. We further conclude that good-faith determinations are irrelevant for determining damages upon a breach of this duty."); *Fireman's Fund Ins. Co. v. Imbesi*, 826 A.2d 735, 749 (N.J. Super. Ct. App. Div. 2003) (quoting *Griggs v. Bertram*, 443 A.2d 163, 171-72 (N.J. 1982)); *Bruce-Terminix Co. v. Zurich Ins. Co.*, 504 S.E.2d 574, 580 (N.C. Ct. App. 1998) (quoting *Jamestown Mut. Ins. Co. v. Nationwide Mut. Ins. Co.*, 176 S.E.2d 751, 754 (N.C. 1970)); *Blake v. Nationwide Ins. Co.*, 904 A.2d 1071, 1076 (Vt. 2006) (stating that an insurer that wrongly denies coverage based on an exclusion "will be liable for a judgment in a case in which it did not participate" (citing *Vance*, 730 S.W.2d at 522)); *Water Wells Sols. Serv. Grp., Inc. v. Consol. Ins. Co.*, 881 N.W.2d 285, 297 (Wis. 2016) ("By declining to defend an insured, an insurer opens itself up to a myriad of adverse consequences if its . . . determination turns out to be wrong. For example, an insurer that breaches its duty to defend is liable for all costs naturally flowing from the breach. This liability is not limited to policy limits . . ." (citations omitted)).

²⁹ *Vance*, 730 S.W.2d at 523; *see Se. Wis. Prof'l Baseball Park Dist. v. Mitsubishi Heavy Indus. Am., Inc.*, 738 N.W.2d 87, 108 (Wis. Ct. App. 2007) (using nearly identical language).

³⁰ *See, e.g., Ayers v. C & D Gen. Contractors*, 269 F. Supp. 2d 911, 914 (W.D. Ky. 2003) (discussing Kentucky law).

³¹ *See, e.g., Brockmann v. Bd. of Cty. Comm'rs*, 404 F. App'x 271, 286 (10th Cir. 2010) (observing that because the county was represented by competent counsel—an assistant county attorney—in lieu of a defense lawyer appointed by the insurer, the insurer's refusal to defend was not a factor in the excess judgment); *Snodgrass v. State Farm Mut. Auto. Ins. Co.*, 804 P.2d 1012, 1022 (Kan. Ct. App. 1991) ("Although State Farm refused to represent [its insured] Owen, he was represented by competent counsel in a case in which Owen's liability was clear and [the underlying plaintiff's] injuries were extensive, and there was no offer to settle within State Farm's policy limits. . . . [T]here is no basis to conclude that judgment would have been for a lesser sum if State Farm had defended Owen."); *Burgraff v. Menard, Inc.*, 875 N.W.2d 596, 609 (Wis. 2016) ("Menard cannot demonstrate that the amount of the jury verdict was a result of the breach. Menard chose its own counsel and there is no assertion that it would have achieved a better result at trial had [the insurer] chosen Menard's counsel.").

³² *Snodgrass*, 804 P.2d at 1022.

³³ *See, e.g., Hyland v. Liberty Mut. Fire Ins. Co.*, 885 F.3d 482, 487 (7th Cir. 2018) ("[The insured's] liability was too clear for argument; counsel could not have hoped to defeat [the

altered the outcome.³⁴ Either way, no one can reasonably argue that the insurer's breach of its duty to defend the insured caused any excess judgment; in other words, any excess judgment did not naturally flow from the breach.³⁵

The same is true if the insured settles the case for an amount exceeding the policy limits after the insurer breaches the duty to defend. The settlement should reflect the reasonable value of the plaintiff's claim; this settlement value should not depend upon or be increased by the insurer's breach of its duty to defend.³⁶ Likewise, if the insured enters into a consent judgment as part of a settlement after the insurer breaches its duty to defend, the amount of that judgment must be reasonable.³⁷ The test for whether a consent judgment is reasonable is what a reasonable and prudent person in the insured's shoes would have paid to settle the plaintiff's claims.³⁸ Assuming the consent judgment to be reasonable in amount and untainted by bad faith, fraud, or collusion on the insured's part, it should not exceed the amount of any settlement that would have been achieved had the insurer defended the insured.

plaintiff's] suit. There was no difference between what counsel could have achieved and what actually happened (a default judgment when [the insured] did not defend herself).”)

³⁴ *Id.* at 486–87.

³⁵ *See generally* 1 WINDT, *supra* note 1, § 4:36, at 4-290 (“In most . . . cases, there is no basis for concluding that a judgment would have been for a lesser amount had the defense been conducted by counsel provided by the insurer. As a result, it cannot be said that the detriment suffered by the insured as a result of a judgment in excess of the policy limits was proximately caused by the insurer’s refusal to defend.” (footnote omitted)).

³⁶ *See Hamlin v. Hartford Accident & Indem. Co.*, 86 F.3d 93, 95 (7th Cir. 1996) (involving a case in which the insurer refused to pay for counsel for the insured, the insured hired its own counsel, and the case settled; there was no evidence that a better settlement might have been achieved with insurer-provided counsel, especially since the plaintiff’s claims against the insured appeared to be “entirely valid”); *Conway v. Country Cas. Ins. Co.*, 442 N.E.2d 245, 249 (Ill. 1982) (“The \$10,000 paid by Conway to [the plaintiff] cannot be said to have been proximately caused by Country Casualty’s breach [of the duty to defend] absent a showing that there could have been a settlement for a lesser amount if Country Casualty had defended the action. . . . There was no such showing . . . and it will be assumed that Conway would have been required to pay . . . \$10,000 even had Country Casualty defended the . . . action against him.” (citation omitted)).

³⁷ *Jimenez v. Gov’t Emps. Ins. Co.*, 651 F. App’x 850, 853 (11th Cir. 2016) (applying Florida law); *Cent. Mut. Ins. Co. v. Tracy’s Treasures, Inc.*, 19 N.E.3d 1100, 1112 (Ill. App. Ct. 2014) (citing *Guillen v. Potomac Ins. Co.*, 785 N.E.2d 1, 14–15 (Ill. 2003)); *Abbey/Land L.L.C. v. Interstate Mech., Inc.*, 345 P.3d 1032, 1034 (Mont. 2015); *Forsman v. Blues, Brews & Bar-B-Ques, Inc.*, 903 N.W.2d 524, 529 (N.D. 2017) (quoting *Medd v. Fonder*, 543 N.W.2d 483, 485 (N.D. 1996)); *W. Nat’l Mut. Ins. Co. v. TSP, Inc.*, 904 N.W.2d 52, 56 n.1 (S.D. 2017).

³⁸ *Cont’l Cas. Co. v. Hempel*, 4 F. App’x 703, 717 (10th Cir. 2001) (applying New Mexico law); *Waddell v. Titan Ins. Co.*, 88 P.3d 1141, 1146 (Ariz. Ct. App. 2004) (quoting *United Servs. Auto. Ass’n v. Morris*, 741 P.2d 246, 254 (Ariz. 1987)); *Guillen*, 785 N.E.2d at 14 (quoting *Miller v. Shughart*, 316 N.W.2d 729, 735 (Minn. 1982)); *Red Giant Oil Co. v. Lawlor*, 528 N.W.2d 524, 535 (Iowa 1995); *Cambridge Mut. Fire Ins. Co. v. Perry*, 692 A.2d 1388, 1391 (Me. 1997); *Jorgensen v. Knutson*, 662 N.W.2d 893, 904 (Minn. 2003) (quoting *Miller*, 316 N.W.2d at 735).

Finally, along these lines, an insurer's breach of the duty to defend cannot be said to have proximately caused an insured's excess liability in a case in which the plaintiff was unwilling to settle within policy limits,³⁹ or in which the plaintiff simply made no offer to settle within policy limits.⁴⁰ In such a case, the plaintiff cannot show that the insurer's defense of the insured would have prevented an excess judgment.⁴¹

It is also possible to conclude that an insurer's mistaken breach of the duty to defend should not result in extracontractual liability by essentially reverse engineering an insurer's performance of its duty in a representative case. To explain, consider that an insurer that defends its insured in a case of clear coverage, declines the plaintiff's offer to settle within policy limits, and takes the case to trial and loses an excess verdict is not necessarily liable for the portion of the judgment that exceeds its policy limits.⁴² For the insurance company to face extracontractual liability in that scenario, its decision not to settle within policy limits, despite the opportunity to do so, must rise to the level of bad faith as defined in the jurisdiction.⁴³ In other words, where an insurer fully performs its

³⁹ See, e.g., *Liberty Mut. Fire Ins. Co. v. Canal Ins. Co.*, 177 F.3d 326, 336–38 (5th Cir. 1999) (applying Mississippi law).

⁴⁰ *George R. Winchell, Inc. v. Norris*, 633 P.2d 1174, 1177 (Kan. Ct. App. 1981) (en banc).

⁴¹ *Liberty Mut. Fire Ins. Co.*, 177 F.3d at 337; *George R. Winchell, Inc.*, 633 P.2d at 1177–78.

⁴² See, e.g., *Surgery Ctr. at 900 N. Mich. Ave., L.L.C. v. Am. Physicians Assurance Corp.*, 922 F.3d 778, 784–87 (7th Cir. 2019) (applying Illinois law in a case that the insurer, the defense counsel, and the insured's president considered defensible); *Christian Builders, Inc. v. Cincinnati Ins. Co.*, 501 F. Supp. 2d 1224, 1230–40 (D. Minn. 2007) (applying Minnesota law); *Johnson v. Am. Family Mut. Ins. Co.*, 674 N.W.2d 88, 90–91 (Iowa 2004) (quoting *Ferris v. Emp'rs Mut. Cas. Co.*, 122 N.W.2d 263, 267 (Iowa 1963)); *Henke v. Iowa Home Mut. Cas. Co.*, 97 N.W.2d 168, 173 (Iowa 1959); *Eskind v. Marcel*, 951 So. 2d 289, 293 (La. Ct. App. 2006) (“A liability insurer, in the absence of bad faith, is generally free to settle or to litigate at its own discretion, without liability to its insured for a judgment in excess of the policy limits.”); *Silva v. Norfolk & Dedham Mut. Fire Ins. Co.*, 75 N.E.3d 1132, 1135–39 (Mass. App. Ct. 2017) (reasoning that because a legitimate difference of opinion existed as to the extent of the plaintiff's injuries and there was ample evidence to suggest that the plaintiff was not injured nearly as badly as he claimed to be, the insurer's failure to make settlement offer within its \$250,000 policy limit prior to \$818,000 verdict for the plaintiff was not unfair claim settlement practice).

⁴³ *JERRY & RICHMOND*, *supra* note 3, at 732–34, 738–39. For an insurer to be found liable for bad faith for not settling within policy limits in some jurisdictions, a plaintiff must establish that the insurer engaged in dishonest, malicious, or oppressive conduct carried out with a state of mind characterized by hatred, ill will, or revenge to avoid an obligation to the insured. See, e.g., *Sims v. State Farm Mut. Auto. Ins. Co.*, 894 F.3d 941, 945 (8th Cir. 2018) (quoting *Aetna Cas. & Sur. Co. v. Broadway Arms Corp.*, 664 S.W.2d 463, 465 (Ark. 1984)); *Unum Life Ins. Co. of Am. v. Edwards*, 210 S.W.3d 84, 87 (Ark. 2005); see *Missler v. State Farm Ins. Co.*, 41 N.E.3d 297, 302 (Ind. Ct. App. 2015) (stating that liability for bad faith requires evidence of a state of mind reflecting dishonest purpose, moral obliquity, furtive design, or ill will (quoting *Mahan v. Am. Standard Ins. Co.*, 862 N.E.2d 669, 677 (Ind. Ct. App. 2007))). Other jurisdictions are less stringent and hold only that an insured must “show more than just negligence” by the insurer to prevail on a bad faith claim. *Purscell v. Tico Ins. Co.*, 790 F.3d 842, 847 (8th Cir. 2015) (applying Missouri

duty to defend and is not guilty of bad faith, its liability is capped at its policy limits even though the insured's damages exceed the policy limits.⁴⁴ That being so, the insurer's mistaken breach of its duty to defend should not expose it to extracontractual liability. Rather, extracontractual liability—if any—must result from the insurer's unreasonable failure to settle the third party's lawsuit against the insured within policy limits and not from the insurer's breach of its duty to defend.⁴⁵

What this reverse engineering exercise illustrates, of course, is the key contract law principle that damages for breach are intended to restore the injured party, as near as may be, to the position it would have enjoyed had the breaching party instead performed its obligations.⁴⁶ The injured party is not entitled to be placed in a better position than it would have occupied had there been no breach.⁴⁷ The non-breaching party is not entitled to receive a windfall.⁴⁸ In our context, awarding an insured extracontractual damages for a liability insurer's simple breach of the duty to defend puts the insured in a better position than it would have occupied had there been no breach. After all, had the insurer defended the insured and legitimately declined to settle the case within policy limits in favor of going to trial, the insured—not the insurer—would be responsible for paying that portion of any judgment that exceeded the policy's liability limits. The minority position thus grants the insured a windfall.

law). Still, in other jurisdictions, an insurer may be exposed to extracontractual liability if it acted negligently in settling a claim or suit against its insured. *See, e.g., Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 89 (Kan. 1997) (discussing a liability insurer's duty to act "in good faith and without negligence" in settlement).

⁴⁴ *See, e.g., Christian Builders*, 501 F. Supp. 2d at 1230–40 (finding no bad faith in a case the insurer vigorously defended and thus capping the insurer's liability at its policy limits).

⁴⁵ *See generally Landie v. Century Indem. Co.*, 390 S.W.2d 558, 563 (Mo. Ct. App. 1965) ("It is now beyond dispute . . . that where the company does assume the defense of a suit against its insured it may be liable over and above its policy limits if it acts in bad faith, or in some jurisdictions acts negligently, in refusing to settle the claim against its insured within its policy limits. . . . Conversely, where the company in good faith believes there is a valid defense to the claim, even though the defense proves unsuccessful and results in a judgment against the insured above the policy limits, the company is not liable, because of such honest mistake, beyond the limits of its policy." (citations omitted)).

⁴⁶ *Legacy Data Access, Inc. v. Cadrillion, L.L.C.*, 889 F.3d 158, 168 (4th Cir. 2018) (applying North Carolina law); *Brookewood, Ltd. v. DeQueen Physical Therapy & Occupational Therapy, Inc.*, 547 S.W.3d 461, 467 (Ark. Ct. App. 2018); *WSC/2005 L.L.C. v. Trio Venture Assocs.*, 190 A.3d 255, 268 (Md. 2018); *Cain v. Price*, 415 P.3d 25, 30 (Nev. 2018).

⁴⁷ *IBM Corp. v. State ex rel. Ind. Family & Soc. Servs. Admin.*, 112 N.E.3d 1088, 1105 (Ind. Ct. App. 2018); *G4S Tech. L.L.C. v. Mass. Tech. Park Corp.*, 99 N.E.3d 728, 735 (Mass. 2018) (quoting *Ficara v. Belleau*, 117 N.E.2d 287, 289 (Mass. 1954)).

⁴⁸ *Legacy Builders, L.L.C. v. Andrews*, 335 P.3d 1063, 1068 (Wyo. 2014).

B. The Minority Rule in Action: The Andrew Case

As noted earlier, *Andrew* is the latest state supreme court case to have adopted the minority rule regarding the extracontractual consequences of breach of the duty to defend, and the decision was anxiously awaited in insurance law circles. The decision in *Andrew* is worth examining both because the court deviated from the majority rule and because the court was careful to qualify the minority rule by holding that the insured must prove that the insurer's breach of its duty to defend caused an excess judgment.⁴⁹ The *Andrew* court further softened the minority rule when it stated that the insured must "take all reasonable means to protect himself and mitigate his damages" caused by the insurer's breach.⁵⁰

1. Background and Facts

Andrew arose out of a personal injury action. In January 2009, Ryan Pretner was riding his bicycle in Las Vegas, Nevada, when he was struck in the head by the side-view mirror of a pickup truck driven by Michael Vasquez.⁵¹ Pretner suffered a catastrophic brain injury in the accident.⁵²

Vasquez was insured under a personal auto policy issued by Progressive Insurance and a commercial liability policy issued to his business, Blue Streak Auto Detailing ("Blue Streak"), by Century Surety Co.⁵³ Following the accident, Vasquez told the police that he had just gotten off work and was en route from his house to his uncle's home when he struck Pretner.⁵⁴ He also signed an affidavit to that effect.⁵⁵ Vasquez gave a recorded statement to Progressive in which he said that he was off work and running errands at the time of the accident.⁵⁶ He did not report the accident to Century until March 2009 "because he felt that the accident did not occur while he was driving on Blue Streak business."⁵⁷ When he finally did speak with a Century adjuster, he reiterated that he was not on Blue Streak business at the time of the accident.⁵⁸

⁴⁹ Century Sur. Co. v. Andrew, 432 P.3d 180, 186 (Nev. 2018).

⁵⁰ *Id.* (quoting Thomas v. W. World Ins. Co., 343 So. 2d 1298, 1303 (Fla. Dist. Ct. App. 1977)).

⁵¹ Andrew v. Century Sur. Co., No. 2:12-cv-00978-APG-PAL, 2013 WL 5592889, at *1 (D. Nev. Oct. 10, 2013).

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

In May 2009, Pretner and his legal guardian, Dana Andrew, made a policy limits settlement demand on Century.⁵⁹ Approximately one month later, Century denied coverage to Vasquez and Blue Streak because Vasquez was not acting in the course and scope of Blue Streak business at the time of the accident.⁶⁰ Century also rejected the plaintiffs' settlement demand based on the absence of coverage.⁶¹

In January 2011, Pretner and Andrew sued Vasquez and Blue Streak in Nevada state court.⁶² They alleged in their complaint that Vasquez was Blue Streak's agent and employee, and that he was acting in the course and scope of his employment when he negligently struck Pretner with his truck.⁶³ Century again denied coverage based on Vasquez's many post-accident statements that he was not on Blue Streak business at the time of the accident.⁶⁴ Because it denied coverage for the accident, Century also declined to defend the lawsuit against Vasquez and Blue Streak.⁶⁵

Century's denial of a defense based on facts extrinsic to the plaintiffs' complaint rather than defending Vasquez and Blue Streak under a reservation of rights based on the facts alleged in the complaint would prove to be fateful. As subsequent events would amply demonstrate, Century apparently overlooked

[t]he general rule . . . that insurers may not use facts outside the complaint as the basis for refusing to defend, with the result that even an insurer with a strong factual basis for contesting coverage must defend under a reservation of rights and then file a declaratory-judgment action to terminate the duty to defend.⁶⁶

Anyway, neither Blue Streak nor Vasquez answered the lawsuit and the plaintiffs took defaults against them.⁶⁷ Vasquez and Blue Streak subsequently entered into a settlement agreement with the plaintiffs under which Progressive paid the plaintiffs its \$100,000 policy limit, the plaintiffs agreed to limit execution on any judgment against Vasquez and Blue Streak to insurance proceeds, and Vasquez and Blue Streak assigned their rights against Century to the plaintiffs.⁶⁸

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.* at *2.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Andrew v. Century Sur. Co.*, 134 F. Supp. 3d 1249, 1253 (D. Nev. 2015).

⁶⁶ RESTATEMENT OF THE LAW OF LIAB. INS. § 13 cmt. c (AM. LAW INST. 2019).

⁶⁷ *Andrew*, 2013 WL 5592889, at *2.

⁶⁸ *Id.*

In February 2012, the plaintiffs applied for a default judgment of just under \$12.5 million in compensatory damages, and in their application recited that Vasquez was in the course and scope of his employment with Blue Streak when his truck struck Pretner.⁶⁹ No one opposed the application for a default judgment.⁷⁰ The state court heard the application in April 2012 and, again, there was no opposition.⁷¹ The state court thus entered a default judgment against Blue Streak and Vasquez which recited that Vasquez was Blue Streak's agent and employee, that he was acting in the course and scope of his employment when he negligently caused the accident, and that Blue Streak was therefore liable for Pretner's injuries.⁷² The court awarded the plaintiffs slightly more than \$18 million in damages, including attorney's fees.⁷³

In April 2012, the plaintiffs sued Century in Nevada state court for bad faith and breach of contract.⁷⁴ In June 2012, Century removed the case to federal court.⁷⁵

2. The Federal Court Action

In the federal case, the parties filed cross-motions for summary judgment, which the district court denied.⁷⁶ Both sides asked the district court to reconsider that order, which it did.⁷⁷ A key question on reconsideration was whether Century had breached its duty to defend and, if so, what the measure of any damages might be.⁷⁸

The district court concluded that Century had breached its duty to defend because the plaintiffs' complaint in the state court action alleged that Vasquez was acting in the course and scope of his employment with Blue Streak when he injured Pretner.⁷⁹ Thus, there had at least been a potential for coverage under the policy.⁸⁰

With respect to damages, the plaintiffs argued that "when an insurer breaches the duty to defend, the appropriate finding is liability against the insurer

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.* at *2–3.

⁷³ *Id.* at *3.

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Andrew v. Century Sur. Co.*, No. 2:12-cv-00978-APG-PAL, 2014 WL 1764740, at *1 (D. Nev. Apr. 29, 2014).

⁷⁷ *Id.*

⁷⁸ *Id.* at *3.

⁷⁹ *Id.* at *6.

⁸⁰ *Id.*

for the full amount of the resulting judgment, even if it exceeds the policy limits.”⁸¹ The district court weighed Nevada authority on contract damages, surveyed case law from other states, and concluded that in circumstances such as these, “the Nevada Supreme Court would not allow for extra-contractual damages if the insurer did not act in bad faith.”⁸² Here, there was no evidence of bad faith by Century.⁸³ “To the contrary, its investigation revealed that the accident likely was not a covered event.”⁸⁴ As the court noted, in denying coverage, Century reasonably relied on Vasquez’s many unequivocal statements that he was not on Blue Streak business at the time of the accident.⁸⁵

“Absent bad faith,” the court explained, “the breach of the duty to defend results in typical contractual damages.”⁸⁶ The court therefore concluded that the plaintiffs could recover “the damages incurred as a result of Century’s breach of its duty to defend that were reasonably foreseeable at the time of the contract, but those damages [were] capped by the \$1 million limit” of the Century policy.⁸⁷ The determination of the plaintiffs’ actual damages would require a trial.⁸⁸

Then, in September 2015, the district court reconsidered its ruling that Century’s liability for breach of its duty to defend was capped at its \$1 million policy limit.⁸⁹ In a stunning display of indecisiveness, the court pivoted 180 degrees and decided “that the default judgment was a reasonably foreseeable consequential damage caused by Century’s breach of its duty to defend its insured.”⁹⁰

The court observed that under Nevada law, compensatory damages for a breach of contract include expectancy damages.⁹¹ Here, Blue Streak’s expectancy damages included the cost of defense plus payment of the Century policy limits up to \$1 million.⁹² Furthermore, Blue Streak was due consequential damages caused by Century’s breach of the duty to defend.⁹³ Consequential damages are those that “aris[e] naturally, or were reasonably contemplated by both parties at the time they made the contract.”⁹⁴ As the court viewed matters,

⁸¹ *Id.* at *9.

⁸² *Id.* (citations omitted).

⁸³ *Id.* at *10.

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.* at *11.

⁸⁸ *Id.*

⁸⁹ *Andrew v. Century Sur. Co.*, 134 F. Supp. 3d 1249, 1252 (D. Nev. 2015).

⁹⁰ *Id.*

⁹¹ *Id.* at 1254.

⁹² *Id.* (citing RESTATEMENT (SECOND) OF CONTRACTS § 347(a) (AM. LAW INST. 1981)).

⁹³ *Id.* at 1255 (citing RESTATEMENT (SECOND) OF CONTRACTS § 347(b) (AM. LAW INST. 1981)).

⁹⁴ *Id.* (quoting *Hornwood v. Smith’s Food King No. 1*, 772 P.2d 1284, 1286 (Nev. 1989)).

“[w]hen the insurer breaches the duty to defend, a default judgment is a reasonably foreseeable result because, in the ordinary course, when an insurer refuses to defend its insured, a probable result is that the insured will default.”⁹⁵ Century need not have acted in bad faith to incur extracontractual liability because:

One explanation of the reasoning behind th[e] rule [that bad faith is required for extracontractual damages for breach of the duty to defend] is that “the measure of damages for the breach of a contract for the payment of money is the amount agreed to be paid with interest,” and a breach of the duty to defend “cannot be held to enlarge the limitation as to the amount fixed as reimbursement for injuries to persons.” This explanation does not address consequential damages resulting from the breach of the duty to defend. The duty to defend is not based on the contractual promise to pay a certain amount of money to an injured person. Instead, it is a promise to provide a defense, the breach of which may result in consequential damages to the insured beyond the policy limits. *Mannheimer*’s reasoning makes sense in terms of the duty to indemnify because absent bad faith, the parties would expect the insurer to pay only the policy limits on indemnification. But it does not explain why a breach of the duty to defend should be subject to the policy’s indemnification limit, which is a separate duty with separate remedies for its breach.⁹⁶

For obvious reasons, genuine issues of material fact remained regarding whether the settlement agreement and default judgment were fraudulent or collusive,⁹⁷ and thus whether Century was bound thereby.⁹⁸ Those issues would have to await a jury trial.⁹⁹

⁹⁵ *Id.*

⁹⁶ *Id.* at 1256 (quoting *Mannheimer Bros. v. Kansas Cas. & Sur. Co.*, 184 N.W. 189, 191 (Minn. 1921)).

⁹⁷ Before settling, Vasquez steadfastly insisted that he was not working for Blue Streak at the time of the accident. *Id.* at 1268. Progressive never defended Vasquez despite his insistence that Pretner bore fault for the accident; Progressive provided him a lawyer only to advise him concerning the settlement agreement. *Id.* at 1268–69. Vasquez initially did not want to sign the settlement agreement “because he maintained his position that he was not at work at the time of the accident and therefore Century should not be liable.” *Id.* at 1269. Nevertheless, he agreed to a default in exchange for a promise to limit execution on the judgment to the Century policy. *Id.* “A reasonable jury could find that agreement set the stage for Pretner’s counsel to obtain a default judgment that manufactured coverage even though there was no evidence supporting coverage under the Century policy.” *Id.*

⁹⁸ *Id.* at 1270.

⁹⁹ *Id.*

Before the case could be tried, the U.S. Court of Appeals for the Ninth Circuit certified the following question to the Nevada Supreme Court in another case:

Whether, under Nevada law, the liability of an insurer that has breached its duty to defend, but has not acted in bad faith, is capped at the policy limit plus any costs incurred by the insured in mounting a defense, or is the insurer liable for all losses consequential to the insurer's breach?¹⁰⁰

The *Andrew* parties urged the district court to certify the same question to the Nevada Supreme Court, and the district court did precisely that in August 2017.¹⁰¹

3. The Nevada Supreme Court Decision in *Andrew*

The Nevada Supreme Court answered the district court's certified question by stating that "an insurer's liability where it breaches its contractual duty to defend is not capped at the policy limits plus the insured's defense costs, and instead, an insurer may be liable for the consequential damages caused by its breach."¹⁰² The court further concluded "that good-faith determinations are irrelevant for determining damages upon breach of this duty."¹⁰³

In reaching these conclusions, the *Andrew* court explained that legal principles applicable to contracts generally are applicable to insurance policies, and that in a breach of contract case the injured party may recover expectancy damages as outlined in section 347 of the Restatement (Second) of Contracts.¹⁰⁴ Such damages include, in addition to benefit of the bargain damages, "any other loss, including incidental or consequential loss, caused by the breach,"¹⁰⁵ minus any cost or other loss that the injured party avoids by not having to perform its contractual obligations.¹⁰⁶

In the liability insurance context, an insurer owes its insured two separate, express contractual duties: a duty to defend and a duty to indemnify.¹⁰⁷ The duty to indemnify shields the insured against adverse judgments, "while the

¹⁰⁰ *Andrew v. Century Sur. Co.*, No. 2:12-cv-00978-APG-PAL, 2017 WL 3484726, at *2 (D. Nev. Aug. 14, 2017).

¹⁰¹ *Id.*

¹⁰² *Century Sur. Co. v. Andrew*, 432 P.3d 180, 182 (Nev. 2018).

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 183.

¹⁰⁵ *Id.* (quoting RESTATEMENT (SECOND) OF CONTRACTS § 347(b) (AM. LAW INST. 1981)).

¹⁰⁶ *Id.* (quoting RESTATEMENT (SECOND) OF CONTRACTS § 347(c) (AM. LAW INST. 1981)).

¹⁰⁷ *Id.*

duty to defend protects those insured from the action itself.”¹⁰⁸ Indeed, an insured pays its premium with the expectation that the insurer will honor its duty to defend if and when the duty arises.¹⁰⁹

In a case in which the duty to defend arises and the insurer breaches it, “the insurer is at least liable for the insured’s reasonable costs in mounting a defense in the underlying action.”¹¹⁰ But what about the insurer’s liability for the full amount of any judgment that follows its breach of duty?

The *Andrew* court surveyed the majority and minority positions regarding an insurer’s extracontractual liability for breaching the duty to defend.¹¹¹ After doing so, the court concluded that the minority view reflected the better approach:¹¹²

Unlike the minority view, the majority view places an artificial limit to the insurer’s liability within the policy limits for a breach of its duty to defend. That limit is based on the insurer’s duty to indemnify but “[a] duty to defend limited to and coextensive with the duty to indemnify would be essentially meaningless; insureds pay a premium for what is partly litigation insurance designed to protect . . . the insured from the expense of defending suits brought against him.” . . . Indeed, the insurance policy limits “only the amount the insurer may have to pay in the performance of the contract as compensation to a third person for personal injuries caused by the insured; they do not restrict the damages recoverable by the insured for a breach of contract by the insurer.”

The obligation of the insurer to defend its insured is purely contractual and a refusal to defend is considered a breach of contract. Consistent with general contract principles, the minority view provides that the insured may be entitled to consequential damages resulting from the insurer’s breach of its contractual duty to defend. Consequential damages “should be such as may fairly and reasonably be considered as arising naturally, or were reasonably contemplated by both parties at the time they made the contract.” The determination of the insurer’s

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 184.

¹¹⁰ *Id.* (citing *Reyburn Lawn & Landscape Designers, Inc. v. Plaster Dev. Co.*, 255 P.3d 268, 278 (Nev. 2011)).

¹¹¹ *Id.* at 184–85.

¹¹² *Id.* at 185.

liability depends on the unique facts of each case and is one that is left to the jury's determination.¹¹³

In summary, even in the absence of bad faith, an insurer that breaches its duty to defend may be liable for the entire amount of a judgment that exceeds its policy limits if the excess judgment is a consequence of its breach.¹¹⁴ An insurer "refuses to defend at its own peril."¹¹⁵

The *Andrew* court was careful to say that the entire amount of any judgment is not "automatically a consequence" of the insurer's breach of its duty to defend.¹¹⁶ Rather, the insured must prove that the insurer's breach of its duty to defend caused an excess judgment.¹¹⁷ The insured must also "take all reasonable means to protect himself and mitigate his damages."¹¹⁸

4. Analysis

Andrew is at best an incompletely reasoned decision. Most obviously, the Nevada Supreme Court never focused on the principle that damages for breach of contract are intended to restore the injured party to the position it would have occupied had there been no breach; the injured party is not entitled to improve its position through recovery for the breach.¹¹⁹ That was a significant oversight, because Nevada law quite clearly embraces that principle.¹²⁰

It is no answer to say that extracontractual liability is a fair measure of consequential damages because Vasquez expected Century to defend him in the underlying action. For one thing, Vasquez never expected a defense; he never believed that Century owed him any obligations in connection with the

¹¹³ *Id.* at 185–86 (citations omitted).

¹¹⁴ *Id.* at 186.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.* (quoting *Thomas v. W. World Ins. Co.*, 343 So. 2d 1298, 1303 (Fla. Dist. Ct. App. 1977)).

¹¹⁹ See *supra* notes 46–48 and accompanying text.

¹²⁰ See, e.g., *Road & Highway Builders, L.L.C. v. N. Nev. Rebar, Inc.*, 284 P.3d 377, 392 (Nev. 2012) ("[I]n contracts cases, compensatory damages 'are awarded to make the aggrieved party whole and . . . should place the plaintiff in the position he would have been in had the contract not been breached.'" (quoting *Hornwood v. Smith's Food King No. 1*, 807 P.2d 208, 211 (Nev. 1991))); *Dalton Props., Inc. v. Jones*, 683 P.2d 30, 31 (Nev. 1984) ("The object of compensatory damages in an action for breach of contract is merely to place the injured party in the position that he would have been in had the contract not been breached."); *Hennen v. Streeter*, 31 P.2d 160, 163 (Nev. 1934) ("In case of [a] breach of contract, the injured party can only recover damages, and he cannot be damaged in a greater sum than he would have received had there been no breach.").

accident.¹²¹ For another thing, the compensatory damages portion of the consent judgment was over \$12 million¹²² and there was no evidence before the court that a vigorous defense would have reduced that amount.

If, in the abstract, Vasquez might have expected Century to settle the underlying case when the plaintiffs demanded that it do so and thereby spare him uninsured liability, that speculative and unfounded failure would have been separate and apart from Century's breach of its duty to defend. One would have had nothing to do with the other. In fact, Vasquez did not believe that Century should be liable for the consent judgment,¹²³ and it is difficult to see how he could have reasonably expected Century to settle for policy limits given the apparent lack of coverage based on his many statements about being on a personal errand at the time of the accident.¹²⁴ Moreover, an insurer may decline to settle a lawsuit against its insured within policy limits when the insurer does not owe coverage for the related occurrence.¹²⁵ In some jurisdictions, an insurer cannot be liable for bad faith for failing to settle within policy limits when it has a reasonable basis in fact or law for contesting coverage.¹²⁶ All the evidence indicated that Century did not owe coverage for the underlying occurrence, so it had no duty to

¹²¹ See *supra* notes 52–56 and accompanying text; *Andrew v. Century Sur. Co.*, 134 F. Supp. 3d 1249, 1269 (D. Nev. 2015) (recounting that Vasquez initially did not want to sign the settlement agreement that resolved the underlying lawsuit “because he maintained his position that he was not at work at the time of the accident and therefore Century should not be liable”).

¹²² *Andrew v. Century Sur. Co.*, No. 2:12-cv-00978-APG-PAL, 2013 WL 5592889, at *2 (D. Nev. Oct. 10, 2013).

¹²³ *Andrew v. Century Sur. Co.*, 134 F. Supp. 3d 1249, 1269 (D. Nev. 2015).

¹²⁴ See *supra* notes 52–56 and accompanying text.

¹²⁵ See *Twin City Fire Ins. Co. v. Colonial Life & Accident Ins. Co.*, 375 F.3d 1097, 1101 (11th Cir. 2004) (stating that “both South Carolina and Alabama law require insurance coverage as a prerequisite for liability for a bad faith failure to settle a claim”); *ACE Am. Ins. Co. v. Fireman’s Fund Ins. Co.*, 206 Cal. Rptr. 3d 176, 181 (Ct. App. 2016) (“California recognizes ‘an implied duty on the part of the insurer to accept reasonable settlement demands on [covered] claims within the policy limits.’” (quoting *Hamilton v. Md. Cas. Co.*, 41 P.3d 128, 132 (Cal. 2002))); *Piedmont Office Realty Tr., Inc. v. XL Specialty Ins. Co.*, 771 S.E.2d 864, 866 (Ga. 2015) (stating that “an insurer cannot unreasonably refuse to settle a covered claim”); *Am. Family Mut. Ins. Co. v. Westfield Ins. Co.*, 962 N.E.2d 993, 1000 (Ill. App. Ct. 2011) (“An insurer has a duty to act in good faith in responding to settlement offers . . . but that duty only exists where there is coverage under the policy.” (citation omitted)); *Rocor Int’l, Inc. v. Nat’l Union Fire Ins. Co.*, 77 S.W.3d 253, 261 (Tex. 2002) (“Under the common law, an insurer generally has no obligation to settle a third-party claim against its insured unless the claim is covered under the policy.” (citation omitted)).

¹²⁶ See, e.g., *Associated Wholesale Grocers, Inc. v. Americold Corp.*, 934 P.2d 65, 90 (Kan. 1997) (asserting that “an insurance company should not be required to settle a claim when there is a good faith question as to whether there is coverage under its insurance policy” (quoting *Snodgrass v. State Farm Mut. Auto. Ins. Co.*, 804 P.2d 1012, 1022 (Kan. 1991))); *State Farm Mut. Auto. Ins. Co. v. Freyer*, 312 P.3d 403, 418 (Mont. 2013) (noting that under Montana law as established in a prior case, “an insurer does not act in bad faith in rejecting a settlement if it had a reasonable basis in law or fact to contest the claim or the amount of the claim”).

settle within policy limits; it certainly had a reasonable basis for disputing coverage.

As for the Nevada Supreme Court's reasoning that confining damages for breach of the duty to defend to policy limits "places an artificial limit" on the insurer's liability by blending the duty to defend with the separate duty to indemnify the insured,¹²⁷ well, not exactly. First, "an insurer does not promise an insured against all claims, whatever they might be."¹²⁸ An insurer has no duty to defend a lawsuit against its insured if there is no basis on which the insurer may be obligated to indemnify the insured.¹²⁹ Phrased slightly differently, an insurer has no duty to defend its insured when there is no possibility of coverage.¹³⁰ Second, standard liability insurance policies provide that the insurer's duty to defend ends when the insurer has exhausted its policy limits through the payment of judgments or settlements.¹³¹ In short, an insurer's duty to defend and duty to indemnify are not as distant from one another as the *Andrew* court would appear to have believed. There is accordingly nothing incongruous about limiting an insurer's liability for breach of the duty to defend to the policy limits plus defense costs.

Importantly, the Nevada Supreme Court did not hold that an insurer's simple breach of its duty to defend automatically exposes it to extracontractual liability.¹³² Rather, the extent or scope of the insurer's liability for breaching the duty to defend requires case-specific inquiry.¹³³ And remember, consequential damages for an insurer's breach of the duty to defend must have been foreseeable to the insurer at the time of contracting¹³⁴—not when the claim was made, the insured was sued, or thereafter.¹³⁵

¹²⁷ *Century Sur. Co. v. Andrew*, 432 P.3d 180, 185 (Nev. 2018) (quoting *Capitol Envtl. Servs., Inc. v. N. River Ins. Co.*, 536 F. Supp. 2d 633, 640 (E.D. Va. 2008)).

¹²⁸ *JERRY & RICHMOND*, *supra* note 3, at 692.

¹²⁹ *Zurich Am. Ins. Co. v. ACE Am. Ins. Co.*, 86 N.Y.S.3d 468, 469 (App. Div. 2018).

¹³⁰ *Mau v. Twin City Fire Ins. Co.*, 910 F.3d 388, 390–91 (8th Cir. 2018) (discussing North Dakota law); *All Green Elec., Inc. v. Sec. Nat'l Ins. Co.*, 231 Cal. Rptr. 3d 449, 454 (Ct. App. Div. 2018); *Spencer v. Hartford Cas.*, 556 S.W.3d 679, 683 (Mo. Ct. App. 2018).

¹³¹ *See, e.g., Ins. Servs. Office, Inc., Commercial General Liability Coverage Form (CG 00 01 014 13)*, at 1 (2012) ("Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements . . ." (emphasis omitted)).

¹³² *Andrew*, 432 P.3d at 186.

¹³³ *Id.* (citing *Khan v. Landmark Am. Ins. Co.*, 757 S.E.2d 151, 155 (Ga. Ct. App. 2014)).

¹³⁴ *Bainbridge, Inc. v. Travelers Cas. Co. of Conn.*, 159 P.3d 748, 756 (Colo. App. 2006); *Andrew*, 432 P.3d at 186 (quoting *Hornwood v. Smith's Food King No. 1*, 772 P.2d 1284, 1286 (Nev. 1989)).

¹³⁵ *See Nw. Pump & Equip. Co. v. Am. States Ins. Co.*, 925 P.2d 1241, 1244 (Or. Ct. App. 1996) (en banc) ("Consequential damages are, by definition, those that the parties to a contract reasonably contemplate *at the time of execution, not at some later date.*" (latter emphasis added)).

III. THE MAJORITY RULE CAPPING LIABILITY AT THE POLICY LIMITS

Contrary to the outcome in *Andrew*, and as noted earlier, an insurer's mistaken breach of the duty to defend generally does not expose the company to extracontractual liability.¹³⁶ All the reasons that render the minority rule infirm

¹³⁶ See, e.g., *Nalder v. United Auto. Ins. Co.*, 824 F.3d 854, 857 (9th Cir. 2016) (quoting *Comunale v. Traders & Gen. Ins. Co.*, 328 P.2d 198, 201 (Cal. 1958)); *Quorum Health Res., L.L.C. v. Maverick Cty. Hosp. Dist.*, 308 F.3d 451, 468 (5th Cir. 2002) (applying Texas law and stating that damages for an insurer's breach of the duty to defend are capped at policy limits); *Liberty Mut. Fire Ins. Co. v. Canal Ins. Co.*, 177 F.3d 326, 336 (5th Cir. 1999) (Under Mississippi law, "if the insurer has acted in good faith, it is not liable for any amount beyond the stated policy limit. With respect to excess judgments, an insurer is not liable for the amount in excess of the policy limit so long as the insurer has not acted in bad faith and has not wrongfully refused to settle the claim within its policy limits." (footnotes omitted)); *Am. Safety Cas. Ins. Co. v. City of Waukegan*, 776 F. Supp. 2d 670, 702 (N.D. Ill. 2011) ("Under Illinois law, . . . 'the mere failure to defend does not, in the absence of bad faith, render the insurer liable for that amount of the judgment in excess of the policy limits.'" (quoting *Conway v. Country Cas. Ins. Co.*, 442 N.E.2d 245, 249 (Ill. 1982))); *Cincinnati Ins. Co. v. Grand Pointe, L.L.C.*, 501 F. Supp. 2d 1145, 1174 (E.D. Tenn. 2007) ("Under Tennessee law an insurer which breaches its duty to defend is liable for the amount of the policy plus the reasonable costs incurred in providing a defense for its insured."); *Spence-Parker v. Md. Ins. Grp.*, 937 F. Supp. 551, 557–58 (E.D. Va. 1996) (applying Virginia law and requiring bad faith to impose extracontractual liability for breach of the duty to defend); *Quihuis v. State Farm Mut. Auto. Ins. Co.*, 334 P.3d 719, 730 (Ariz. 2014) (stating that if an insurer breaches its duty to defend and "a court later finds coverage, the insurer must pay the damages awarded in the default judgment (at least up to the policy limits) unless it can prove fraud or collusion"); *Desert Mountain Props. Ltd. P'ship v. Liberty Mut. Fire Ins. Co.*, 236 P.3d 421, 444 (Ariz. Ct. App. 2010) ("An insurer's wrongful failure to indemnify or defend its insured 'does not expose the insurance carrier to greater liability than that contractually provided in the policy.'" (quoting *State Farm Mut. Auto. Ins. Co. v. Paynter*, 593 P.2d 948, 954 (Ariz. Ct. App. 1979))); *Capstone Bldg. Corp. v. Am. Motorists Ins. Co.*, 67 A.3d 961, 993 (Conn. 2013) ("If the insurer declines to provide its insured with a defense and is subsequently found to have breached its duty to do so, it bears the consequences of its decision, including the payment of any reasonable settlement agreed to by the plaintiff and the insured, and the costs incurred effectuating the settlement up to the limits of the policy."); *State Farm Mut. Auto. Ins. Co. v. Horkheimer*, 814 So. 2d 1069, 1071 (Fla. Dist. Ct. App. 2001) ("Absent a showing of bad faith, a judgment cannot be entered against an insurer in excess of its policy limits."); *Colonial Oil Indus. Inc. v. Underwriters Subscribing to Policy Nos. TO31504670 & TO31504671*, 491 S.E.2d 337, 339 (Ga. 1997) ("[W]hen the insurer breaches the contract by wrongfully refusing to provide a defense, the insured is entitled to receive only what it is owed under the contract—the cost of defense. The breach of the duty to defend, however, should not enlarge indemnity coverage beyond the parties' contract."); *Johnson v. Westhoff Sand Co.*, 62 P.3d 685, 699 (Kan. Ct. App. 2003) ("[A]n insurer who wrongfully refuses to defend an action against its insured is not liable for the amount of a judgment in excess of policy limits, absent a showing by the insured that the excess judgment is traceable to the refusal to defend."); *Arceneaux v. Amstar Corp.*, 66 So. 3d 438, 452 (La. 2011) ("The duty to defend is provided in the insurance contract; therefore, its breach is determined by ordinary contract law principles and the insurer is liable for the insured's reasonable defense costs."); *Mesmer v. Md. Auto. Ins. Fund*, 725 A.2d 1053, 1064 (Md. 1999) ("[T]he damages for breach of the contractual duty to defend are limited to the insured's expenses, including attorney fees, in defending the underlying tort action, as well as the insured's expenses and attorney fees in a separate contract or declaratory judgment action if such action is filed to establish that there exists a duty to defend."); *Engeldinger v. State Auto. & Cas.*

support courts' adoption of the majority rule. The majority rule is not absolute, however. Courts that generally cap an insurer's liability for breach of the duty to defend at policy limits plus the insured's defense costs may permit extracontractual liability where it is "traceable" to the insurer's breach.¹³⁷ Such circumstances are rare, but they may exist where (a) the insurer's breach of the duty to defend is coupled with bad faith; (b) the insurer misleads the insured about providing a defense; or (c) the insured is unable to defend itself.

A. Breach of the Duty to Defend Coupled with Bad Faith

An insurer may face extracontractual liability for breaching the duty to defend where the breach is coupled with conduct by the insurer that qualifies as third-party or first-party bad faith. In such cases, the insurer's extracontractual liability is held to be traceable to the insurer's breach of the duty to defend.

1. Third-Party Bad Faith Requirement

Third-party bad faith is generally understood to refer to an insurer's unreasonable refusal to settle a lawsuit against its insured within the policy limits.¹³⁸ An insurer's duty to make reasonable settlement decisions—and thus to settle cases or claims against its insured within policy limits in some circumstances—is independent from its duty to defend.¹³⁹ Thus, an insurer that breaches its duty to defend does not simultaneously breach its duty to settle,¹⁴⁰ that is, the insurer does not simultaneously commit third-party bad faith. The seeming combination of the two breaches, however, may subject the insurer to

Underwriters, 236 N.W.2d 596, 602 (Minn. 1975) (reaffirming the rule announced in *Mannheimer Bros. v. Kansas Casualty & Surety Co.*, 184 N.W. 189, 191 (Minn. 1921)); *Allen v. Bryers*, 512 S.W.3d 17, 38 (Mo. 2016) (stating that an insurer that mistakenly breaches its duty to defend is liable up to the policy limits plus attorney's fees, expenses, and other damages (quoting *Landie v. Century Indem. Co.*, 390 S.W.2d 558, 562 (Mo. Ct. App. 1965)); *Gedeon v. State Farm Mut. Auto. Ins. Co.*, 188 A.2d 320, 322 (Pa. 1963) ("[T]he amount of [the] recovery for breach of the [duty to defend] is the cost of hiring substitute counsel and other costs of the defense, and not the judgment obtained against the insured."); *Waite v. Aetna Cas. & Sur. Co.*, 467 P.2d 847, 851 (Wash. 1970) (en banc) ("[W]here an insurer wrongfully refuses to defend, it will be required to pay the judgment or settlement to the extent of its policy limits and also to reimburse the insured for his costs reasonably incurred in defense of the action.").

¹³⁷ *Johnson*, 62 P.3d at 699.

¹³⁸ See Douglas R. Richmond, *Defining and Confining Institutional Bad Faith in Insurance*, 46 TORT TRIAL & INS. PRAC. L.J. 1, 6 (2010) ("In the liability insurance context, most bad faith claims arise out of an insurer's failure to settle a covered claim or suit against its insured within its policy limits despite the opportunity to do so, followed by a judgment against the insured exceeding those limits." (footnote omitted)).

¹³⁹ JERRY & RICHMOND, *supra* note 3, at 744.

¹⁴⁰ *Id.*

extracontractual liability.¹⁴¹ The requirement of bad faith for extracontractual liability for breach of the duty to defend and the interplay between the two offenses is illustrated by two Missouri Supreme Court cases: *Columbia Casualty Co. v. HIAR Holdings, L.L.C.*,¹⁴² and *Allen v. Bryers*.¹⁴³

In *Columbia Casualty*, a class of plaintiffs sued HIAR Holdings under the Telephone Consumer Protection Act (“TCPA”) after a marketing company that worked for HIAR sent around 12,500 unsolicited fax advertisements (better known as junk faxes) to recipients in two area codes.¹⁴⁴ HIAR tendered defense of the suit to Columbia Casualty, which in December 2002 declined to defend HIAR based on a lack of coverage.¹⁴⁵ Columbia Casualty declined to defend HIAR for a second time in October 2003.¹⁴⁶

In March 2005, the plaintiffs offered to settle with HIAR for an amount within its insurance policy limits, which were \$1 million per occurrence and \$2 million in the aggregate.¹⁴⁷ HIAR sent the settlement offer to Columbia Casualty, which again denied coverage and declined to defend HIAR.¹⁴⁸ Columbia Casualty also rejected the plaintiffs’ settlement offer and refused to join in settlement negotiations.¹⁴⁹ Consequently, HIAR defended the case at its own expense until it settled for \$5 million in January 2007.¹⁵⁰ In April 2007, the trial court approved the settlement, entered a judgment for the class, and approved HIAR’s assignment to the class of its claims against Columbia Casualty and any other insurer potentially on the risk.¹⁵¹

The class sought to collect the \$5 million judgment plus post-judgment interest through a garnishment action against Columbia Casualty.¹⁵² In response, Columbia Casualty filed a declaratory judgment (“DJ”) action to determine its duties to defend and indemnify HIAR.¹⁵³ The garnishment action was stayed pending the outcome of the DJ action.¹⁵⁴

¹⁴¹ In fact, it is the insurer’s allegedly unreasonable failure to settle within policy limits that subjects it to extracontractual liability; the insurer’s breach of the duty to defend is simply a precipitating event.

¹⁴² 411 S.W.3d 258 (Mo. 2013) (en banc).

¹⁴³ 512 S.W.3d 17 (Mo. 2016).

¹⁴⁴ *Columbia Cas.*, 411 S.W.3d at 261–62.

¹⁴⁵ *Id.* at 262.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 262 & n.5.

¹⁴⁸ *Id.* at 262.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.* at 263.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

In the DJ action, the trial court determined that Columbia Casualty was obligated to defend HIAR in the class action because the class's TCPA claims were covered as "advertising injury" and because they sought "property damage."¹⁵⁵ The trial court also held that Columbia Casualty was liable for the full \$5 million settlement amount, plus post-judgment interest.¹⁵⁶ The trial court reasoned that "an insurer that wrongly refuses to defend cannot thereafter litigate the reasonableness of an indemnification amount and becomes liable for the entire underlying judgment as damages flowing from its breach of its duty to defend."¹⁵⁷ Columbia Casualty appealed to the Missouri Supreme Court.

The *Columbia Casualty* court sided with the class right out of the gate, stating that an "insurer that wrongly refuses to defend is liable for the underlying judgment as damages flowing from its breach of its duty to defend."¹⁵⁸ Columbia Casualty contended that it could not be liable for the full amount of the settlement because "only a 'bad faith' claim could result in the award of extra-contractual damages, and . . . no 'bad faith' allegation was presented" here.¹⁵⁹ The court was not persuaded.¹⁶⁰ As it had already noted, "Columbia's wrongful refusal to defend HIAR put it in a position to indemnify HIAR for all damages flowing from its breach of the duty to defend."¹⁶¹ The class further insisted that it had sufficiently alleged that Columbia Casualty had acted in bad faith by refusing to defend HIAR and by refusing to participate in settlement negotiations.¹⁶² As the class saw matters, Columbia Casualty's extracontractual liability was merely a known consequence of its breach of its duty to defend HIAR and its failure to settle within its policy limits.¹⁶³

According to the court, because Columbia Casualty wrongly "denied coverage and even a defense under a reservation of rights, and also refused to engage in settlement negotiations," it could not avoid liability for the full amount of the judgment.¹⁶⁴ After considering two additional issues, the *Columbia Casualty* court affirmed the trial court judgment in favor of the class.¹⁶⁵

It is difficult to understand how Columbia Casualty's breach of the duty to defend could have caused the excess judgment against HIAR since HIAR

¹⁵⁵ *Id.* (internal quotation marks omitted).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* (citing *Schmitz v. Great Am. Assurance Co.*, 337 S.W.3d 700, 708–09 (Mo. 2011) (en banc)).

¹⁵⁸ *Id.* at 265 (citing *Schmitz*, 337 S.W.3d at 708–09).

¹⁵⁹ *Id.* at 273.

¹⁶⁰ *Id.*

¹⁶¹ *Id.* (citing *Schmitz*, 337 S.W.3d at 710).

¹⁶² *Id.*

¹⁶³ *Id.* at 273–74 (citing *Shobe v. Kelly*, 279 S.W.3d 203, 209–11 (Mo. Ct. App. 2009)).

¹⁶⁴ *Id.* at 274 (citing *Shobe*, 279 S.W.3d at 209–11).

¹⁶⁵ *Id.*

defended the case at its own expense for five years thereafter. In fact, Columbia Casualty's breach of its duty to defend did *not* cause the excess judgment. The \$5 million consent judgment was the product of Columbia Casualty's failure to settle the class action for policy limits when it had the opportunity to do so. Columbia Casualty's bad faith refusal to settle would be a distinguishing factor three years later in *Allen v. Bryers*.¹⁶⁶

Allen arose out of a personal injury action. John Frank, who owned the Sheridan Apartments in Kansas City, Missouri, had a \$1 million CGL policy with Atain Specialty Insurance Co. ("Atain").¹⁶⁷ In June 2012, Wayne Bryers, who was the property and security manager at the apartments, shot Franklin Allen while ejecting him from the premises.¹⁶⁸ Allen was paralyzed as a result.¹⁶⁹

In August 2012, Allen's lawyer wrote Frank to inform him that Allen intended to assert a negligence claim against Bryers.¹⁷⁰ Allen's lawyer subsequently sent a similar letter to Atain, advising it of the severity of Allen's injury and Allen's forthcoming claims against Frank and Bryers.¹⁷¹

In September 2012, Atain agreed to defend Bryers under a reservation of rights.¹⁷² In its reservation of rights letter, Atain informed Bryers that the policy's bodily injury provision and exclusions for expected or intended injuries, employment-related practices, and assault and battery likely barred coverage for Allen's claim.¹⁷³ Atain ended the reservation of rights letter by stating that it "denie[d] any and all coverage under the policy in connection with [Allen's] claim . . . and furthermore denie[d] that it ha[d] any legal obligation to indemnify [Bryers] in the event a lawsuit [was] filed and a judgment [was] entered against [Bryers]."¹⁷⁴

With its reservation of rights in place, Atain filed a DJ action in federal court in which it alleged that its policy did not cover Bryers because of its assault and battery and expected or intended injury exclusions and because there was no "occurrence."¹⁷⁵ Shortly thereafter, Allen demanded that Atain settle his claim against Bryers for the \$1 million policy limit.¹⁷⁶ Atain rejected Allen's settlement demand.¹⁷⁷ Allen thus prepared to reach a so-called section 537.065 agreement

¹⁶⁶ 512 S.W.3d 17 (Mo. 2016) (en banc).

¹⁶⁷ *Id.* at 23.

¹⁶⁸ *Id.* at 24.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.* (quoting Atain's reservation of rights letter).

¹⁷⁵ *Id.* (quoting Atain's DJ filing).

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 24–25.

with Bryers whereby Allen would limit the collection of any judgment he might obtain against Bryers to insurance proceeds.¹⁷⁸

Allen subsequently sued Bryers for negligence and included in his petition various allegations that were intended to circumvent Atain's coverage defenses.¹⁷⁹ Atain hired defense counsel for Bryers, who filed an answer on his behalf.¹⁸⁰ Bryers then rejected Atain's reservation of rights defense, and the defense lawyers Atain hired for Bryers withdrew from the case.¹⁸¹ On the heels of those events, Bryers withdrew his answer and consented to the entry of judgment against him consistent with his section 537.065 agreement with Allen.¹⁸²

The case proceeded to a bench trial at which Allen won a \$16 million judgment.¹⁸³ The trial court made several factual findings that established coverage for Allen's injuries under the Atain policy.¹⁸⁴ After the judgment became final, Allen filed a garnishment action against Atain to collect the judgment.¹⁸⁵ Ultimately, the garnishment court awarded Allen summary judgment and ordered Atain to pay him \$16 million, reasoning that "'extra-contractual' damages were appropriate because [Atain] was suffering the consequences of its breach of its duty to defend and its failure to settle within the policy limit."¹⁸⁶ Atain appealed to the Missouri Court of Appeals, which transferred the case to the Missouri Supreme Court.¹⁸⁷

The Missouri Supreme Court explained that when Bryers rejected Atain's defense under a reservation of rights, Atain had three options: (1) represent Bryers without a reservation of rights; (2) withdraw from his defense altogether; or (3) file a DJ action to determine coverage.¹⁸⁸ Here, Atain had filed a DJ action long before Bryers rejected its defense under a reservation of rights.¹⁸⁹ Under Missouri law:

¹⁷⁸ See *id.* at 24–25, 25 n.4 (discussing a section 537.065 agreement).

¹⁷⁹ See *id.* at 25 (reciting the allegations in Allen's petition).

¹⁸⁰ *Id.*

¹⁸¹ *Id.* "It is well-settled [under Missouri law] that an insured has the right to reject a reservation of rights defense." *Id.* at 32 (citing *State Farm Mut. Auto. Ins. Co. v. Ballmer*, 899 S.W.2d 523, 527 (Mo. 1995) (en banc)).

¹⁸² *Id.* at 25.

¹⁸³ *Id.* at 26.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 27.

¹⁸⁷ *Id.* at 23 & n.2.

¹⁸⁸ *Id.* at 32 (quoting *Kinnaman-Carson v. Westport Ins. Corp.*, 283 S.W.3d 761, 765 (Mo. 2009) (en banc)).

¹⁸⁹ *Id.*

An insurer's decision to file a declaratory judgment action instead of foregoing its reservation of rights defense is a risky one. By filing a declaratory judgment action, the insurer's decision is treated as a refusal to defend, and, if determined to be "unjustified, the insurer is treated as if it waived any control of the defense of the underlying tort action." In this case, [Atain] wrongfully refused to defend Bryers. . . . Instead of defending Bryers, [Atain] asserted a full reservation of rights, denied coverage, and filed a declaratory judgment action in federal district court before Allen's petition was filed.

Once an insurer unjustifiably refuses to defend or provide coverage, the insured may enter into an agreement with the plaintiff to limit his or her liability to the insurance policy limits.¹⁹⁰

Atain disputed its liability for the \$16 million judgment.¹⁹¹ Again, the garnishment court held that because Atain wrongly refused to defend Bryers, it had to indemnify him in connection with the section 537.065 agreement.¹⁹² The garnishment court further rejected Atain's argument that it could not be liable for damages in excess of its policy limit in the absence of bad faith.¹⁹³ In so deciding, the garnishment court cited *Columbia Casualty* for the proposition that Atain had to suffer the consequences of breaching its duty to defend and failing to settle for policy limits.¹⁹⁴ Atain argued that the garnishment court misinterpreted *Columbia Casualty*.¹⁹⁵ The Missouri Supreme Court agreed with Atain.¹⁹⁶

The *Allen* court explained that, in *Columbia Casualty*, the court hearing the DJ action "explicitly found [that] the insurer engaged in bad faith when it both refused to defend and to settle the claim."¹⁹⁷ *Columbia Casualty* did not appeal that determination.¹⁹⁸ Thus, because it was held to have "acted in bad faith for refusing both to defend and to settle, [Columbia Casualty] was liable for the

¹⁹⁰ *Id.* (citations omitted).

¹⁹¹ *Id.* at 37.

¹⁹² *Id.*

¹⁹³ *Id.* at 37–38.

¹⁹⁴ *Id.* at 38.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* According to the Missouri Supreme Court's decision in *Columbia Casualty*, the trial court hearing the DJ action "found that Columbia acted unreasonably and in bad faith in handling HIAR's claim for coverage in the TCPA action initiated by the class." *Columbia Cas. Co. v. HIAR Holding, L.L.C.*, 411 S.W.3d 258, 263 (Mo. 2013) (en banc). It is not clear from that summary of the trial court's findings how Columbia Casualty acted in bad faith in failing to defend HIAR as the *Allen* court recited.

¹⁹⁸ *Allen*, 512 S.W.3d at 38.

entire amount of the judgment beyond the policy limits.”¹⁹⁹ Here, although the garnishment court found that Atain had breached its duty to defend and refused to settle within policy limits, “it made no finding of bad faith.”²⁰⁰ The garnishment court therefore “exceeded its authority in awarding Allen the full amount of the underlying tort judgment because Allen was only entitled to the \$1 million policy limits” under longstanding Missouri caselaw.²⁰¹ “Accordingly, the garnishment court erred in entering judgment in excess of the \$1 million policy limit.”²⁰²

Again, the contrasting holdings in *Columbia Casualty* and *Allen* pivoted on the finding of bad faith in the former and the lack of a similar finding in the latter. Absent a finding of bad faith in *Allen*, there was no basis to award extracontractual damages for Atain’s breach of its duty to defend Bryers.

2. An Insurer’s First-Party Bad Faith May Result in Extracontractual Liability for Breaching the Duty to Defend

Although liability insurance is third-party insurance and an insurer’s refusal to settle within policy limits may support third-party bad faith allegations, an insured’s right to a defense is sometimes characterized as a first-party benefit.²⁰³ Thus, in a state that recognizes a first-party bad faith cause of action,²⁰⁴ an insurer may face extracontractual liability if it refuses to defend an insured in bad faith or withdraws a defense in bad faith.²⁰⁵ An insurer may be liable for bad faith in refusing to defend an insured or in withdrawing a defense already offered when it does so (a) without a reasonable basis for its actions and (b) with knowledge of its duty to defend or in reckless disregard of whether it had a duty

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.* at 39 (referring to *Landie v. Century Indem. Co.*, 390 S.W.2d 558 (Mo. Ct. App. 1965)).

²⁰² *Id.*

²⁰³ See, e.g., 1 WILLIAM T. BARKER & RONALD D. KENT, *NEW APPLEMAN INSURANCE BAD FAITH LITIGATION* § 3:08[3] (2d ed. 2019) (describing an insured’s right to a defense as a first-party benefit).

²⁰⁴ Liability for first-party bad faith generally requires the insured to prove that (1) the insurer had no reasonable basis for denying the claim and (2) the insurer knew that there was no reasonable basis for denying the claim or acted with reckless disregard for the existence of such a basis. *Hayes v. Metro. Prop. & Cas. Ins. Co.*, 908 F.3d 370, 374 (8th Cir. 2018) (citing *Bailey v. Farmers Union Coop. Ins. Co.*, 498 N.W.2d 591, 599 (Neb. Ct. App. 1992)) (applying Nebraska law); *De Stefano v. Apts. Downtown, Inc.*, 879 N.W.2d 155, 188 (Iowa 2016) (quoting *Kiner v. Reliance Ins. Co.*, 463 N.W.2d 9, 12 (Iowa 1990)); *Rancosky v. Wash. Nat’l Ins. Co.*, 170 A.3d 364, 365, 376 (Pa. 2017) (discussing the standard for statutory bad faith in Pennsylvania). “[T]he reasonableness of an insurer’s decision to deny or delay benefits to its insured must be evaluated based on the information that was before the insurer at the time it made its coverage decision.” *Schultz v. GEICO Cas. Co.*, 429 P.3d 844, 848–49 (Colo. 2018).

²⁰⁵ BARKER & KENT, *supra* note 203.

to defend.²⁰⁶ Furthermore, because a liability insurer that agrees to defend its insured must perform its duty to defend with due care,²⁰⁷ an insurer that conducts the defense unreasonably and with knowledge that it is conducting the defense unreasonably or with reckless disregard of its defense obligations may face extracontractual liability.²⁰⁸ Finally, as the conjunction “and” clearly signals, a plaintiff must prove both (a) and (b) to establish an insurer’s bad faith in refusing to defend, or in withdrawing or mishandling a defense.

In *Pershing Park Villas Homeowners Ass’n v. United Pacific Insurance Co.*,²⁰⁹ for example, Reliance Insurance Co. withdrew its defense of the defendant real estate developers four months before trial.²¹⁰ Reliance did so based on a coverage opinion from outside counsel.²¹¹ Although Reliance had previously reserved its rights to deny coverage for the lawsuit, it never filed a DJ action to determine its obligations.²¹² The developers did not retain substitute counsel to defend the suit, and the plaintiffs obtained a \$339,000 default judgment against them.²¹³ The developers were forced to seek bankruptcy protection as a result of the default judgment, and the damage to their credit impaired their ability to do business going forward.²¹⁴ A jury found that Reliance acted in bad faith in withdrawing its defense, and while Reliance appealed the verdict on a variety of grounds, it did not dispute the jury’s finding that it wrongfully withdrew the developers’ defense.²¹⁵ “Reliance [was] therefore liable to the developers for the amount of the judgment, and all other damages consequential to it.”²¹⁶

Similarly, in *Pacific Indemnity Co. v. Acel Delivery Service, Inc.*,²¹⁷ the insurer, which had been defending the insured for over one and a half years,

²⁰⁶ See RESTATEMENT OF THE LAW OF LIAB. INS. § 49 (AM. LAW INST. 2019) (“Liability for Insurance Bad Faith”); see also *Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc.*, 93 Cal. Rptr. 2d 364, 387 (Ct. App. 2000) (“A breach of the duty to defend in itself constitutes only a breach of contract . . . but it may also violate the covenant of good faith and fair dealing where it involves unreasonable conduct or an action taken without proper cause.” (citations omitted)).

²⁰⁷ JERRY & RICHMOND, *supra* note 3, at 716.

²⁰⁸ It is important to understand that in such circumstances the insurer is not being held vicariously liable for the negligence or other misconduct of the defense counsel it hired for the insured. Rather, the insurer is being held liable for its own mishandling of the defense.

²⁰⁹ 219 F.3d 895 (9th Cir. 2000).

²¹⁰ *Id.* at 898.

²¹¹ *Id.*

²¹² *Id.*

²¹³ *Id.*

²¹⁴ *Id.*

²¹⁵ *Id.* at 902.

²¹⁶ *Id.*

²¹⁷ 485 F.2d 1169 (5th Cir. 1973).

withdrew its defense less than one month before trial.²¹⁸ In fact, Pacific Indemnity should have been able to make an informed decision about its defense and indemnity obligations to the insured at the outset of the litigation or reasonably soon thereafter had it adequately investigated relevant events.²¹⁹ Although the insured retained replacement counsel to handle the trial, the *Pacific Indemnity* court concluded that the insurer's withdrawal of the defense prejudiced the insured because it "deprived the [insured] of the opportunity to present a more forceful defense."²²⁰ The court affirmed the district court's determination that the insurer was estopped to deny coverage for the accident underlying the litigation.²²¹ A corresponding result was reached in *Beckwith Machinery Co. v. Travelers Indemnity Co.*,²²² where the insurer abruptly withdrew its defense after 13 months and, in the process, effectively denied the insured the opportunity to investigate the plaintiff's claims.²²³ The *Beckwith* court branded Travelers's conduct "obdurate and contumacious" and held that Travelers had waived and was estopped from asserting any coverage defenses.²²⁴

*Delatorre v. Safeway Insurance Co.*²²⁵ is an interesting case involving an insurer's unreasonable conduct of the insured's defense. Bonifacio Delatorre was a passenger in a car driven by Ruben Delatorre when they were involved in an accident with another vehicle.²²⁶ Bonifacio and the two occupants of the other vehicle all sued Ruben, who was insured under a personal auto policy with Safeway Insurance with liability limits of \$20,000 per person and \$40,000 per accident.²²⁷ Bonifacio made a policy limits settlement demand on Safeway, which the insurer declined.²²⁸ Safeway did, however, agree to defend Ruben in the lawsuits against him under a reservation of rights.²²⁹ Safeway hired lawyer I.R. Strizak to defend Ruben in Bonifacio's lawsuit.²³⁰

Strizak filed an entry of appearance and answer on Ruben's behalf in December 1992 but did nothing more to defend Ruben.²³¹ Safeway paid no fees to Strizak for defending Ruben; for that matter, Strizak did not even submit any

²¹⁸ *Id.* at 1175.

²¹⁹ *Id.* at 1174–75.

²²⁰ *Id.* at 1176.

²²¹ *Id.* at 1177.

²²² 638 F. Supp. 1179 (W.D. Pa. 1986).

²²³ *Id.* at 1188.

²²⁴ *Id.* at 1187.

²²⁵ 989 N.E.2d 268 (Ill. App. Ct. 2013).

²²⁶ *Id.* at 270.

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ *Id.*

invoices to Safeway in connection with Ruben's representation.²³² When Strizak did not respond to discovery, Bonifacio obtained a default judgment against Ruben in December 1994.²³³ Bonifacio's lawyer sent a copy of the default order to Safeway, which forwarded it to Strizak.²³⁴ This was the only written communication that Safeway had or attempted with Strizak in the two years since it had retained him to defend Ruben.²³⁵ Strizak never responded.²³⁶ In November 1995, the court held a "prove-up hearing" on the default judgment and awarded Bonifacio \$250,000.²³⁷ Ruben then assigned his rights against Safeway to Bonifacio, who sued Safeway for breach of contract, vexatious and unreasonable delay in settling his claim, and punitive damages.²³⁸ In particular, Bonifacio alleged that Safeway breached its duty to defend "when it ignored notice that Strizak was not providing Ruben with a meaningful defense."²³⁹ Bonifacio further alleged that because of Safeway's inadequate defense, Ruben became subject to the \$250,000 default judgment.²⁴⁰

Bonifacio prevailed at summary judgment on his claim for breach of the duty to defend.²⁴¹ He subsequently filed a supplemental summary judgment motion on the issue of damages, which Safeway opposed in part on the basis that its liability for breach of contract was capped at the policy limits.²⁴² Bonifacio won that motion, too, and the trial entered a \$250,000 judgment plus costs in his favor.²⁴³ Safeway promptly appealed.

The case presented a unique issue on appeal: "whether an insurer that has retained counsel to defend its insured, may, in certain limited circumstances, still be found to have breached its duty to defend."²⁴⁴ The court reasoned that the question required an affirmative answer because otherwise an insurer could "escape its legal obligation to provide good faith representation and instead freely abandon its insured to an attorney who either is unwilling or unable to undertake the defense, or who, as in this case, inexplicably desert[ed] the

²³² *Id.*

²³³ *Id.*

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.* at 274.

²³⁷ *Id.* at 270.

²³⁸ *Id.* at 271.

²³⁹ *Id.*

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

²⁴⁴ *Id.* at 273.

client.”²⁴⁵ Persuaded by an analogous Seventh Circuit case,²⁴⁶ the court decided “that retaining an attorney, standing alone, does not discharge an insurer’s duty to defend.”²⁴⁷ In making this determination, the *Delatorre* court rejected Safeway’s opposing argument:

[Safeway] maintains that it did more than merely retain an attorney. Specifically, when it learned that its insured had been subject to an order of default, it sent the order to Strizak. The circuit court found this limited action was insufficient to satisfy [Safeway’s] duty to defend, and we agree. Significantly, we do not question the *means* [Safeway] used to contact Strizak, but rather the fact that there is no evidence that [it] made any further effort to obtain an explanation from Strizak as to why the default was entered, or whether he sought to have it vacated. Indeed, [Safeway] admit[ted] that with the exception of the letter forwarding the notice of default, it had no written communication with Strizak between December 3, 1992, when Strizak accepted responsibility for Ruben’s defense, until over three years after entry of the default judgment against Ruben.²⁴⁸

In summary, Safeway’s “nominal, passive, and one-way communication” with Strizak breached its duty to defend Ruben.²⁴⁹

With the question of breach decided, the court turned to damages.²⁵⁰ Bonifacio had established in the trial court that both the original default and the resulting default judgment resulted entirely from Safeway’s breach of its duty to defend, and Safeway offered no evidence to the contrary.²⁵¹ On that record, the court reasoned that the default judgment—including the portion in excess of the policy limits—flowed directly from Safeway’s breach of its duty to defend.²⁵² In other words, Safeway’s breach of its duty to defend proximately caused the default judgment.²⁵³ As the court noted, “[t]his situation could have been averted altogether had [Safeway] seen to it that its insured was actually defended as contractually required.”²⁵⁴

²⁴⁵ *Id.*

²⁴⁶ *Id.* at 274 (discussing *Thoresen v. Roth*, 351 F.2d 573, 575–76 (7th Cir. 1965)).

²⁴⁷ *Id.*

²⁴⁸ *Id.*

²⁴⁹ *Id.*

²⁵⁰ *Id.* at 275.

²⁵¹ *Id.* at 276.

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ *Id.*

The *Delatorre* court affirmed the trial court judgment for Bonifacio on his breach of contract and related excess liability claims.²⁵⁵ The court did, however, “expressly limit [its] decision on the suitability of the default judgment . . . as the measure of damages to the precise facts of this case, and [did] not decide its applicability to future cases.”²⁵⁶

Delatorre is a case with some holes. Most notably, while Safeway’s failure to direct Ruben’s defense and monitor Strizak’s work in the process may have proximately caused the default and default judgment, it did not necessarily affect the *amount* of the default judgment. In other words, if Bonifacio’s case really was worth \$250,000, as he apparently proved to the trial court’s satisfaction, it is speculative to think that Safeway’s proper defense of Ruben would have produced a lower judgment. After all, Bonifacio was a passenger in Ruben’s car—it was not as though a jury might find him comparatively at fault for the accident. Unfortunately for Safeway, it appears from the opinion that it defended itself in the trial court no more effectively than it defended Ruben.

*Devich v. Commercial Union Insurance Co.*²⁵⁷ is a case in which the court rejected the plaintiffs’ bad faith claim. There, Mike Devich was injured while operating an aerial work platform designed and manufactured by Maverick Mobile Equipment.²⁵⁸ At the time of Devich’s injury, Maverick was insured under a Commercial Union policy with applicable liability limits of \$500,000.²⁵⁹ Devich and his wife sued Maverick on several theories, and Commercial Union promptly opened a claim file.²⁶⁰ After interviewing Maverick’s president, Robert Bajek, Commercial Union denied coverage for the Devichs’ lawsuit based on the products-completed operations hazard exclusion in its policy.²⁶¹ Commercial Union also concluded that it had no duty to defend Maverick and advised Maverick to retain its own lawyer.²⁶² Maverick’s lawyer responded by telling Commercial Union that Maverick intended to allow the Devichs to take a default judgment against it.²⁶³ Commercial Union again denied coverage and refused to defend Maverick.²⁶⁴

The Devichs took a default judgment against Maverick.²⁶⁵ A subsequent bench trial to liquidate the plaintiffs’ damages resulted in a judgment of just over

²⁵⁵ *Id.* at 277.

²⁵⁶ *Id.* at 276–77.

²⁵⁷ 867 F. Supp. 1230 (W.D. Pa. 1994).

²⁵⁸ *Id.* at 1231–32.

²⁵⁹ *Id.* at 1232.

²⁶⁰ *Id.*

²⁶¹ *Id.*

²⁶² *Id.* at 1232–33.

²⁶³ *Id.* at 1233.

²⁶⁴ *Id.*

²⁶⁵ *Id.*

\$859,000.²⁶⁶ Maverick assigned the Devichs its rights under the Commercial Union policy, and the Devichs sued Commercial Union to collect the full amount of the judgment.²⁶⁷

The *Devich* court held that the Devichs' negligent failure to warn claim against Maverick was outside the scope of the products-completed operations hazard exclusion, meaning that Commercial Union had breached its duty to defend Maverick.²⁶⁸ The question then became the amount of damages recoverable for the breach.²⁶⁹ Commercial Union could "be required to indemnify beyond the limits of the policy only if its decision not to defend was made in bad faith," which, under Pennsylvania law, the plaintiffs had to prove by clear and convincing evidence.²⁷⁰ This they could not do. As the court explained:

We hold that Commercial Union did not act in bad faith in denying a defense to Maverick. . . . [T]he facts establish that the carrier acted in good faith based upon a firm belief that the claims were not covered. Immediately after receiving notice of the claim from Maverick, defendant undertook an investigation of the claim, which included interviewing Bajek, to determine the underlying facts relevant to the coverage issue. Once it determined that the injuries to Mike Devich were caused by defects in the aerial platform, [Commercial Union] denied coverage on the basis that the claim fell within the products-completed operations hazard exclusion. Although we have determined that this was a faulty basis for coverage denial, it was not unreasonable for Commercial Union to rely on the exclusion in view of the status of the law in Pennsylvania with respect to the scope of the exclusion.²⁷¹

Case law in other states also supported Commercial Union's policy interpretation.²⁷²

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ *Id.* at 1236.

²⁶⁹ *Id.* ("Where an insurer is found to have breached its duty to defend, the insured may recover the costs of hiring substitute counsel and other costs of the defense. However, such a finding does not, without more, require the insurer to indemnify plaintiffs for the entire amount of the judgment. Because Maverick did not defend against the personal injury claims and incurred no defense costs, plaintiffs cannot claim damages from a finding of breach." (citation omitted)).

²⁷⁰ *Id.*

²⁷¹ *Id.* at 1236–37.

²⁷² *Id.* at 1237.

The *Devich* court held that under the circumstances, Commercial Union's decision not to defend Maverick was not an act of bad faith.²⁷³ Because Commercial Union did not commit bad faith, its liability was capped at its policy limits.²⁷⁴ The court therefore awarded the Devichs \$500,000 rather than the full amount of their default judgment.²⁷⁵

3. Summary

Extracontractual liability for an insurer's bad faith in connection with its breach of the duty to defend should be limited to situations in which (a) the insurer knowingly acts unreasonably in denying a defense,²⁷⁶ withdrawing a defense,²⁷⁷ or conducting the defense of the insured; and (b) the insurer's unreasonable conduct directly results in excess liability. Again, as the conjunction "and" clearly indicates, a plaintiff must prove both (a) and (b) to establish an insurer's bad faith. This approach tracks first-party bad faith law in other contexts. An insurer that unreasonably fails to settle a case or claim within policy limits after breaching its duty to defend should face extracontractual liability only for breaching its implied duty of good faith and fair dealing in failing to settle. There is no need to try to link extracontractual liability for a missed settlement opportunity to the insurer's breach of its duty to defend. As noted earlier, an insurer's duty to settle is independent from its duty to defend.²⁷⁸ A breach of one duty does not necessarily have anything to do with a breach of the other. Extracontractual liability for an insurer's unreasonable failure to settle within policy limits provides an insured with a sufficient remedy for the insurer's bad faith.

B. Misleading the Insured About Providing a Defense May Result in Extracontractual Liability

Beyond bad faith, an insurance company may be responsible for the full amount of a default judgment if the company either through misrepresentations or inaction leads an insured to believe that the company will provide a defense,

²⁷³ *Id.*

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ See, e.g., *Amato v. Mercury Cas. Co.*, 61 Cal. Rptr. 2d 909, 911–14 (Ct. App. 1997) (involving the insurer's "tortious" breach of the duty to defend; the insurer was aware of facts suggesting the possibility of coverage but refused to defend anyway, and the insured did not defend the underlying action at his own expense because he was financially unable to do so).

²⁷⁷ An insurer's unreasonable withdrawal of a defense may have no impact on the case if the insured is able to hire the defense lawyers initially appointed by the insurer to continue the representation at the insured's expense. 1 WINDT, *supra* note 1, § 4:36, at 4-294.

²⁷⁸ JERRY & RICHMOND, *supra* note 3, at 744.

the insured relies on the insurer to defend it and thus does not employ counsel on its own, and the insurer does not defend the insured as expected.²⁷⁹ In that instance, the full amount of the default judgment—including any amounts in excess of the insurer's policy limits—may be held to represent the insured's consequential damages attributable to the insurer's breach of the duty to defend.²⁸⁰ If the insured instead settles with the plaintiff following the insurer's breach, the insurer may still challenge the settlement or the amount thereof on reasonableness grounds or as being procured through bad faith, fraud, or collusion.²⁸¹

*Rushforth Construction Co. v. Wesco Insurance Co.*²⁸² is a recent case in which the insurer refused to communicate its willingness to defend the insured until it was too late.²⁸³ In that case, the court determined that the insurer breached its duty to defend and was guilty of bad faith in delaying its decision to defend the insured under a reservation of rights, but did not impose tort liability for bad faith because the issue of resulting harm to the insured was not presented.²⁸⁴

Rushforth Construction ("Rushforth") was the general contractor on a construction project known as the Lake Hills Village Project.²⁸⁵ It also was an additional insured on an insurance policy issued to one of its subcontractors by Wesco Insurance Co.²⁸⁶ In October 2015, Lake Hills sued Rushforth for defective construction.²⁸⁷ Lake Hills filed an amended complaint in June 2016.²⁸⁸

On July 1, 2016, Rushforth demanded that Wesco defend and indemnify it in connection with the Lake Hills lawsuit.²⁸⁹ Wesco and its third-party claim administrator investigated the matter.²⁹⁰ The Wesco adjuster assigned to the claim drafted a reservation of rights ("ROR") letter on or around September 1, 2016,

²⁷⁹ *Liberty Mut. Fire Ins. Co., v. Canal Ins. Co.*, 177 F.3d 326, 337 (5th Cir. 1999) (citing 1 ALLAN D. WINDT, *INSURANCE CLAIMS & DISPUTES* § 4.36, at 264–67 (3d ed. 1995)); *JERRY & RICHMOND*, *supra* note 3, at 718.

²⁸⁰ 1 WINDT, *supra* note 1, § 4:36, at 4-291; *see, e.g.*, *Gray v. Grain Dealers Mut. Ins. Co.*, 684 F. Supp. 1108, 1112–13 (D.D.C. 1988) (noting the harshness of the rule on the facts of the case); *Leader Nat'l Ins. Co. v. Smith*, 339 S.E.2d 321, 330–31 (Ga. Ct. App. 1985) (involving an insurer that withdrew its defense but did not inform the insured that it was doing so).

²⁸¹ *See JERRY & RICHMOND*, *supra* note 3, at 722 (discussing insureds' settlements following a breach of the duty to defend in general).

²⁸² No. C17-1063-JCC, 2018 WL 1610222 (W.D. Wash. Apr. 3, 2018).

²⁸³ *Id.* at *1, *3.

²⁸⁴ *Id.* at *3, *5 n.8, *6.

²⁸⁵ *Id.* at *1.

²⁸⁶ *Id.*

²⁸⁷ *Id.*

²⁸⁸ *See id.* (stating incorrectly that Lake Hills filed its amended complaint in June 2015).

²⁸⁹ *Id.*

²⁹⁰ *Id.*

and had it in shape for approval and issuance about three weeks later.²⁹¹ Inexplicably, however, Wesco did not issue the ROR letter.²⁹² Nor did Wesco apparently take any position on coverage because, over the next ten months, Rushforth sent Wesco four letters asking it to announce a coverage position.²⁹³ Upon receipt of these letters, Wesco's adjuster sought internal approval to issue the ROR letter, but Wesco neither issued the ROR letter nor replied to Rushforth's requests for a coverage position.²⁹⁴

In July 2017, Rushforth sued Wesco on multiple theories, including breach of contract and bad faith.²⁹⁵ Once Rushforth sued it, Wesco sent Rushforth the ROR letter and agreed to defend Rushforth in the Lake Hills action under the terms outlined in the letter.²⁹⁶ Rushforth rejected Wesco's offer of defense.²⁹⁷

In its lawsuit against Wesco, Rushforth moved for partial summary judgment on Wesco's breach of its duty to defend and its liability for bad faith.²⁹⁸ Wesco cross-moved for summary judgment.²⁹⁹ Construing all facts in Wesco's favor, the *Rushforth* court quickly concluded that Wesco breached its duty to defend Rushforth.³⁰⁰ As the court reasoned:

An insurer's duty to defend is triggered by the filing of a covered complaint. This duty includes the obligation to provide a "prompt and proper defense." An insurer may breach its duty to defend by failing to respond to an insured's tender in a reasonably timely manner. An offer to defend after an initial denial does not erase an insurer's breach of its duty to defend. The Court finds no reason to treat a constructive denial through failure to respond to Plaintiff's tender any differently. . . .

Wesco owed Plaintiff a duty to defend no later than June 20, 2016, when the amended complaint was filed in the underlying action. Wesco did not offer to defend Plaintiff until July 26, 2017—over a year later and after Plaintiff brought suit. Wesco owed and breached its duty to defend Plaintiff.³⁰¹

²⁹¹ *Id.*

²⁹² *Id.*

²⁹³ *Id.*

²⁹⁴ *Id.*

²⁹⁵ *Id.* at *1–2.

²⁹⁶ *Id.* at *1.

²⁹⁷ *Id.*

²⁹⁸ *Id.* at *2.

²⁹⁹ *Id.*

³⁰⁰ *Id.* at *3.

³⁰¹ *Id.* at *2–3 (citations and footnotes omitted).

With respect to Rushforth's bad faith claim, the court observed that an insurer is guilty of bad faith "if its actions are 'unreasonable, frivolous, or unfounded.'"³⁰² Liability for bad faith under Washington law does not require intentional misrepresentation or fraud by the insurer.³⁰³ An insurer's "[f]ailure to promptly respond to a demand for coverage can constitute an unreasonable denial of benefits, even if the insurer eventually offers coverage."³⁰⁴

Here, "reasonable minds could not differ that Wesco's delay was frivolous and unfounded."³⁰⁵ At best, the record reflected Wesco's "unfounded lack of attention to its insureds' claims."³⁰⁶ Wesco could offer no facts to support a reasonable basis for its delay in responding to Rushforth's request for a defense and indemnity that would allow it to survive summary judgment.³⁰⁷ But, while the *Rushforth* court found that Wesco was guilty of bad faith as a matter of law, it declined to find that Wesco had committed the tort of bad faith.³⁰⁸ "Harm is an essential element of a suit for bad faith handling of an insurance claim,"³⁰⁹ and Wesco's duty to indemnify Rushforth and Rushforth's alleged harm were both disputed and were not addressed in the parties' cross-motions.³¹⁰

Assuming *Rushforth* is litigated to conclusion, there currently appears to be no basis for extracontractual liability against Wesco. Rushforth defended the Lake Hills case rather than defaulting or settling via a consent judgment.³¹¹ At this point, Rushforth's damages attributable to Wesco's breach of its duty to defend appear to be limited to its reasonable defense costs.

The lesson for insurers is obvious: if coverage is doubtful, timely offer to defend the insured under a clearly-worded reservation of rights. If there is no possibility of coverage, disclaim a duty to defend or indemnify the insured within a reasonable time after first being asked to provide a defense. Either step should prevent liability based on allegedly misleading conduct or inaction.

C. *The Insured Is Unable to Defend Itself*

Another possible exception to the general rule that an insurer's breach of its duty to defend should not result in extracontractual liability may be found

³⁰² *Id.* at *4 (quoting *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 196 P.3d 664, 668 (Wash. 2008)).

³⁰³ *Id.* (citing *Tyler v. Grange Ins. Ass'n*, 473 P.2d 193, 198 (Wash. Ct. App. 1970)).

³⁰⁴ *Id.*

³⁰⁵ *Id.* at *5.

³⁰⁶ *Id.*

³⁰⁷ *Id.*

³⁰⁸ *Id.* at *5 & n.8.

³⁰⁹ *Id.* (citing *Safeco Ins. Co. v. Butler*, 823 P.2d 499, 503 (Wash. 1992)).

³¹⁰ *Id.* at *6.

³¹¹ *Id.* at *1-4.

where the insured is unable to afford a lawyer and suffers a default judgment that exceeds policy limits as a result.³¹² It is not apparent, however, why extracontractual liability is appropriate in this instance. As noted earlier, damages for breach of contract are intended to restore the injured party to the position it would have enjoyed had the breaching party fulfilled its obligations.³¹³ The injured party is not entitled to be placed in a better position than it would have occupied had there been no breach of contract.³¹⁴ Holding an insurer liable for the full amount of an excess judgment in this situation violates those core contract law principles.

If an insurer were to face extracontractual liability in this situation, it would have to be because it was foreseeable to the insurer at the time of contracting that the insured would be financially unable to defend itself following a breach of the duty to defend by the insurer.³¹⁵ This is because the entire amount of the default judgment must be characterized as a type of consequential damage, and liability for consequential damages requires that the insured's inability to defend itself and resulting default be foreseeable at the time of contracting.³¹⁶ The determination of such foreseeability necessarily requires case- and fact-specific inquiry.³¹⁷

³¹² 1 WINDT, *supra* note 1, § 4:36, at 4-294.

³¹³ Legacy Data Access, Inc. v. Cadrillion, L.L.C., 889 F.3d 158, 168 (4th Cir. 2018) (citation omitted) (applying North Carolina law); Brookewood, Ltd. v. DeQueen Physical Therapy & Occupational Therapy, Inc., 547 S.W.3d 461, 467 (Ark. Ct. App. 2018) (citation omitted); WSC/2005 L.L.C. v. Trio Venture Assocs., 190 A.3d 255, 269 (Md. 2018) (citation omitted); Cain v. Price, 415 P.3d 25, 30 (Nev. 2018) (citing RESTATEMENT (SECOND) OF CONTRACTS § 347 (AM. LAW. INST. 1981)).

³¹⁴ IBM Corp. v. State *ex rel.* Ind. Family & Soc. Servs. Admin., 112 N.E.3d 1088, 1105 (Ind. Ct. App. 2018) (citation omitted); G4S Tech. L.L.C. v. Mass. Tech. Park Corp., 99 N.E.3d 728, 741 (Mass. 2018) (quoting Ficara v. Belleau, 117 N.E.2d 287, 289 (Mass. 1954)).

³¹⁵ See Garcia v. Absolute Bail Bonds, L.L.C., 389 P.3d 161, 167 (Idaho 2016) (“Consequential damages recoverable for breach of contract must be those which ‘were reasonably foreseeable and within the contemplation of the parties at the time they made the contract.’” (quoting *Suits v. First Sec. Bank of Idaho, N.A.*, 713 P.2d 1374, 1381 (Idaho 1985))); *IBM Corp.*, 112 N.E.3d at 1099 (“Consequential damages may be awarded on a breach of contract claim when the non-breaching party’s loss flows naturally and probably from the breach and was contemplated by the parties when the contract was made” (quoting *Berkel & Co. Contractors, Inc. v. Palm & Assocs., Inc.*, 814 N.E.2d 649, 658–59 (Ind. Ct. App. 2004))); *Stern Oil Co. v. Brown*, 908 N.W.2d 144, 151 (S.D. 2018) (“Further, we have required that damages be a direct consequence of the breach of contract and reasonably within the contemplation of the parties at the time of making the contract. To this end, ‘[c]onsequential damages must be reasonably foreseeable by the breaching party at the time of contracting.’” (quoting *Colton v. Decker*, 540 N.W.2d 172, 177 (S.D. 1995))).

³¹⁶ See *Garcia*, 389 P.3d at 167; *IBM Corp.*, 112 N.E.3d at 1099; *Stern Oil Co.*, 908 N.W.2d at 151.

³¹⁷ See *Century Sur. Co. v. Andrew*, 432 P.3d 180, 186 (Nev. 2018) (citing *Khan v. Landmark Am. Ins. Co.*, 757 S.E.2d 151, 155 (Ga. Ct. App. 2014)).

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LIABILITY INSURER'S BREACH

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An insurer should not face extracontractual liability where the insured can afford to hire its own defense counsel but chooses not to do so.³¹⁸ A default in that instance is the product of the insured's choice rather than the insurer's breach.

IV. CONCLUSION

With rare exception, an insurer's simple breach of the duty to defend should not expose it to extracontractual liability; rather, the insurer's liability should be capped at the policy limits plus the insured's defense costs, if any. Extracontractual liability for breach of the duty to defend should require an act of bad faith by the insurer or some other extraordinary circumstance, such as the insurer misleading the insured about the provision of a defense. Indeed, that is the majority rule among those courts that have considered the issue. The minority approach, which holds that an insurer's mistaken breach of its duty to defend may expose it to extracontractual liability, is seriously flawed. The Nevada Supreme Court's recent adoption of the minority approach in its highly-publicized decision in *Century Surety Co. v. Andrew*,³¹⁹ while interesting, is but one more example of a fine court erring in a case involving this important aspect of insurance law.

³¹⁸ 1 WINDT, *supra* note 1, § 4:36, at 4-294 to -295.

³¹⁹ 432 P.3d 180 (Nev. 2018).