

Court Rejects Assertions of Insurer Bad Faith and Holds No Coverage for Affirmative Litigation

October 2010

Applying Washington law, a federal district court has held that an insurer did not act in bad faith by allegedly failing to issue a timely reservation of rights, "commingling coverage and defense functions," or by delaying reimbursement of certain defense costs and expenses. *Amer. Capital Homes, Inc. v. Greenwich Ins. Co.*, 2010 WL 3430495 (W.D. Wash. Aug. 30, 2010). The court also rejected the insureds' coverage claim for costs they incurred in connection with affirmative litigation.

The case involved insurance coverage for a wrongful termination lawsuit brought against the insureds. The insureds' broker tendered notice of the underlying lawsuit to the insurer in September 2007, and the insurer issued an acknowledgment and general reservation of rights shortly thereafter. In October 2007, the insurer issued a second reservation of rights letter, which the broker apparently did not receive until March 2009. The insurer began to issue payments for defense expenses in December 2008, after seeking proof of compliance with certain policy guidelines from the insureds' defense counsel. Under the terms of the policy, the insurer and insureds were to allocate settlements, involving both covered and uncovered losses, based on "relative legal exposures."

The wrongful termination action was mediated in May 2009. At the mediation, the insureds and insurer initially agreed to contribute equally to a settlement proposal, but their allocation negotiations later broke down, and the insurer ultimately settled the action without contribution from the insureds. The insureds refused to resume allocation negotiations and filed this coverage action alleging breach of contract, violation of the Washington Administrative Code (the WAC) and bad faith. The insurer, in turn, asserted breach of contract. In the coverage action, both sides filed motions for partial summary judgment.

The court first rejected the insureds' assertions that the insurer acted in bad faith and in violation of the WAC. In so holding, the court disagreed with the contention that the insurer's delayed reservation of rights constituted bad faith. The court also rejected the assertion that the insurer acted in bad faith by "commingling coverage and defense functions." According to the court, that assertion "has no support in Washington law." With respect to the assertion that the insurer acted in bad faith by delaying certain expense or defense cost payments, the court held that the insureds fail "to show that [the insurer] breached an obligation in a manner

that was unreasonable, frivolous, or unfounded.” The court also held that the insurer's actions did not violate the WAC.

The court also did not agree with the insureds' argument that they were entitled to recover their attorneys' fees in connection with the coverage litigation because they were “forced to file suit to obtain the benefit of their insurance contract.” Similarly, the court held that costs incurred in connection with an affirmative lawsuit that the insureds brought against the underlying plaintiff in the wrongful termination action were not covered under the policy. In so holding, the court distinguished cases cited by the insureds that involved uncovered defense costs that were related to covered defense costs, noting that those cases did not support the insureds' “overreaching assertion that an insurance company should be required to cover the expenses for an affirmative lawsuit.”

Finally, the court denied the insurer's motion for summary judgment on its claim that the insureds breached the insurance contract by refusing to negotiate allocation and contribute to the settlement of the underlying action. The insurer argued that summary judgment was appropriate because the policy requires an allocation and the insureds' counsel had assigned some risk to every count in the underlying action, including those undisputedly not covered by the policy. The court rejected that argument on summary judgment, holding that even if some risk was assigned to uncovered claims, “it does not follow that the final settlement amount was driven in part by those claims.” As such, according to the court, the insurer failed to establish that there was no genuine issue of material fact with respect to the insureds' alleged breach of contract.