



## **Bad Faith Expanded: An Insurer Cannot Deny the Duty to Defend in an Arguable Case, Even if Reasonably Justified**

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Last week, the Washington Supreme Court held that an insurer acts in bad faith as a matter of law when it makes an erroneous coverage determination based on an arguable interpretation of the policy.

In *American Best Food, Inc. v. Alea London, Ltd.*, the insurer, Alea, denied coverage after its insured, American Best, was sued for post-assault negligence. American Best operates Café Arizona, a nightclub in Washington. Café Arizona was sued by one of its patrons, Michael Dorsey, after Dorsey was shot by another patron outside the nightclub. According to Dorsey, after he was shot, the club's security guards carried him inside the club only to have the owner instruct the guards to remove him from the premises. The guards allegedly "dumped [Dorsey] on the sidewalk."

Alea declined to defend because its policy excluded coverage for injuries "arising out of" assault or battery. Although no Washington case had considered whether injuries caused by post-assault negligence "aris[e] out of" assault, Alea relied on a Washington state case finding that injuries "arise out of" an assault or battery when the injuries would not have occurred "but for" the assault or battery and upon several cases broadly construing the phrase "arising out of."

The Washington Supreme Court held, first, that post-assault negligence does not "aris[e] out of" the assault, within the meaning of the policy. The Court held that, for injuries to "aris[e] out of" an event, there must be more than a simple causal connection, although the Court failed to define exactly what more was required. Because Dorsey's post-assault injuries did not "aris[e] out of" the assault on him, the exclusion did not apply, and Alea breached its duty to defend.

Second, the Supreme Court held that Alea acted in bad faith as a matter of law when it denied coverage based on an arguable interpretation of the policy. Alea had argued that, even if its coverage determination was incorrect, it could not be held in bad faith because it relied upon a reasonable interpretation of the law. The Supreme Court disagreed, asserting the rule first announced by its 2007 opinion in *Woo v. Fireman's Fund Insurance Company* that, in "equivocal" cases, an insurer may not rely upon an its own interpretation of case law to refuse to defend. Here, the Court said, Alea "put its own interest ahead of its insured when it denied a defense based on an arguable legal interpretation of its own policy." When coverage is "equivocal," or even when a contrary coverage position is "arguable" (at least when supported by contrary, out-of-state case law), the insurer must give its insured the benefit of the doubt, accept the duty to defend, reserve its rights, and seek declaratory relief.

The Court held that Alea's failure to do so was unreasonable and, therefore, bad faith as a matter of law.

Four justices dissented solely on the bad faith issue, taking the position that an incorrect denial of coverage, including the duty to defend, amounts to bad faith only if the decision was "unreasonable, frivolous, or unfounded," substantially more than merely incorrect. "[B]reach of an insurance contract does not," said the dissenting opinion, "create per se liability for the tort of



bad faith." Rather, the insured must meet the "heavy burden" of proving that the insurer acted in bad faith.

The *Alea* decision has three important implications for insurers:

- An insurer cannot deny coverage for post-assault negligence under an assault or battery exclusion. Post-assault negligence does not "arise out of" the assault or battery.
- When a case involves an arguable interpretation of law, the insurer must give the benefit of the doubt to the insured and provide a defense. The insurer may then reserve rights and seek declaratory relief.
- If, in an equivocal case, the insurer denies the duty to defend, failing to give the benefit of the doubt to its insured, the insurer may be held liable for bad faith even though its denial was based upon a reasonably justified interpretation of the policy.