December 17, 2018

Victory for Policyholders - An Insurer's Breach of the Duty to Defend Opens Up Policy Limits

Insurance companies can no longer breach the duty to defend believing that, as long as they act in good faith, their potential liability is capped at policy limits or any costs incurred by the insured in mounting a defense. In a strong warning to insurance companies and a victory for policyholders, the Nevada Supreme Court held that if an insurer breaches the duty to defend, even in good faith, the policy limits are irrelevant and the insured can recover *all* consequential damages.

In *Century Surety Co. v. Andrew, et. al.,* an employee who used a truck for both personal and business reasons caused an auto accident and injured a minor, Ryan. No. 73756, 134 Nev. Adv. Op. 100 (Nev. Dec. 13, 2018). The employer's liability policy issued by Century had a $1 million limit. After its investigation, Century concluded that the employee had not been driving the truck in the course and scope of his employment at the time of the accident, so Century denied coverage and rejected Ryan's demand to settle within Century's policy limits.

After filing a lawsuit, Ryan obtained a default judgment against the employee and employer, received an assignment of the employer's rights against Century, and then sued Century for breach of contract and unfair claims practices. The United States District Court for the District of Nevada found that Century breached its duty to defend but did not act in bad faith. It also found that the default judgment was a "reasonably foreseeable result of the breach of the duty to defend." The court then stayed its proceedings and certified the following question to the Nevada Supreme Court: Is an insurer's liability capped at the policy limits plus defense costs if the insurer breaches its duty to defend but did not act in bad faith?

On December 13, 2018, the Nevada Supreme Court answered the question. The court affirmed that "insurance policies are treated like other contracts," meaning that an injured party may be entitled to expectancy damages, including all "incidental or consequential loss[es] caused by the breach." Therefore, "[c]onsistent with general contract principles," the Nevada Supreme Court held that "the insured may be entitled to consequential damages resulting from the insurer's breach," even in excess of policy limits. Not only must an insurance company "pay damages necessary to put the insured in the same position" as if there was no breach, but the insured is

entitled to all consequential damages that "fairly and reasonably" and "naturally" arise from the breach, or that "were reasonably contemplated by both parties at the time they made the contract."

Nor does the right to recover consequential damages in excess of policy limits require proof of bad faith. According to the Nevada Supreme Court, the question of bad faith is irrelevant to the straight-forward application of consequential damages in an breach of contract case. An insurance company that breaches its duty to defend, "like any other party who fails to perform its contractual obligations," is liable for foreseeable damages-period.

TAKEAWAY:

The Nevada Supreme Court said it best: "the insurer refuses to defend at its own peril." The holding in *Century Surety Co. v. Andrew* is another powerful tool that a policyholder may use to combat insurance companies. It adds to the insurance companies' potential liabilities if it refuses to defend or otherwise breaches the duty to defend. 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.