

RECEIVED
SUPREME COURT
STATE OF WASHINGTON

No. 80753-1

2008 SEP 22 P 4: 07

IN THE SUPREME COURT OF THE STATE OF WASHINGTON

CLERK

AMERICAN BEST FOOD, INC., a Washington corporation d/b/a CAFÉ
ARIZONA; and MYUNG CHOL SEO and HYUN HEUI SE-JEONG,

Plaintiffs/Respondents,

vs.

ALEA LONDON, LTD., a foreign corporation,

Defendant/Petitioner.

FILED
SUPREME COURT
STATE OF WASHINGTON
2008 SEP 30 P 4: 31
BY RONALD R. CARRETER
CLERK

BRIEF OF AMICUS CURIAE
WASHINGTON STATE TRIAL LAWYERS ASSOCIATION
FOUNDATION

Bryan P. Harnetiaux
WSBA No. 5169
517 E. 17th Avenue
Spokane, WA 99203
(509) 624-3890

David M. Beninger
WSBA No. 18432
705 5th Avenue, Suite 6700
Seattle, WA 98104
(206) 467-6090

On Behalf of
Washington State Trial Lawyers Association Foundation

TABLE OF CONTENTS

	Page
I. IDENTITY AND INTEREST OF AMICUS CURIAE	1
II. INTRODUCTION AND STATEMENT OF THE CASE	1
III. ISSUES PRESENTED	5
IV. SUMMARY OF ARGUMENT	5
V. ARGUMENT	7
A.) Overview Of The Law Regarding Liability Insurers' Duty To Defend, And Insurance Bad Faith Generally.	8
B.) In Light Of The Complaint Allegation Rule, An Insurer Acts In Good Faith In Refusing To Defend Based Upon A Misinterpretation Of The Law Only If It Is Reasonably Debatable The Claim Is <i>Clearly Not Covered</i> .	14
VI. CONCLUSION	18

TABLE OF AUTHORITIES

	Page
<u>Cases</u>	
<u>American Best Food, Inc. v. Alea London, Ltd.</u> , 138 Wn.App. 674, 158 P.3d 119 (2007), <i>review granted</i> , 163 Wn.2d 1039 (2008)	passim
<u>Coventry v. American States Ins. Co.</u> , 136 Wn.2d 269, 961 P.2d 933 (1998)	11-12
<u>Ellwein v. Hartford Co.</u> , 142 Wn.2d 766, 15 P.3d 640 (2001)	17
<u>Felice v. St. Paul Fire & Marine Ins.</u> , 42 Wn.App. 352, 711 P.2d 1066 (1985)	16
<u>Greer v. Northwestern Nat'l Ins. Co.</u> , 109 Wn.2d 191, 743 P.2d 1244 (1987)	9-10
<u>Hayden v. Mutual of Enumclaw</u> , 141 Wn.2d 55, 1 P.3d 1167 (2000)	8,11,15
<u>Holland America Ins. v. National Idemn.</u> , 75 Wn.2d 909, 454 P.2d 383 (1969)	11
<u>Kirk v. Mt. Airy Ins. Co.</u> , 134 Wn.2d 558, 951 P.2d 1124 (1998)	passim
<u>Leingang v. Pierce County Med. Bureau, Inc.</u> , 131 Wn.2d 133, 930 P.2d 288 (1997)	14,16
<u>McGreevy v. Oregon Mut. Ins. Co.</u> , 128 Wn.2d 26, 904 P.2d 731 (1995)	10
<u>Mulcahy v. Farmers Ins. Co.</u> , 152 Wn.2d 92, 95 P.3d 313 (2004)	11,15
<u>Mut. of Enumclaw v. Paulson Constr.</u> , 161 Wn.2d 903, 169 P.3d 1 (2007);	passim
<u>Olympic Steamship Co., Inc. v. Centennial Ins. Co.</u> , 117 Wn.2d 37, 811 P.2d 673 (1991)	10

<u>Safeco Ins. v. Butler,</u> 118 Wn.2d 383, 823 P.2d 499 (1992)	8,10,11,16
<u>Smith v. Safeco Ins. Co.,</u> 150 Wn.2d 478, 78 P.3d 1274 (2003)	11,17
<u>Smith v. Ohio Cas. Ins.,</u> 37 Wn.App. 71, 678 P.2d 829 (1984)	16
<u>Tank v. State Farm Fire & Cas. Co.,</u> 105 Wn.2d 381, 715 P.2d 1133 (1986)	8,9
<u>Transcontinental Ins. Co. v. Wash. Pub. Utils. Dists' Util. Sys.,</u> 111 Wn.2d 452, 760 P.2d 337 (1988)	12
<u>Truck Ins. Exch. v. VanPort Homes,</u> 147 Wn.2d 751, 58 P.3d 454 (2002)	passim
<u>Woo v. Fireman's Fund Ins. Co.,</u> 161 Wn.2d 43, 164 P.3d 276 (2007)	passim

Statutes, Rules & Regulations

Ch. 284-30 WAC	3
CR 57	11
Title 48 RCW	3
WAC 284-30-330(3)	4,17
WAC 284-30-330(13)	18

Other Authorities

Thomas V. Harris, <u>Washington Insurance Law,</u> (2 nd ed. 2006)	11
--	----

I. IDENTITY AND INTEREST OF AMICUS CURIAE

The Washington State Trial Lawyers Association Foundation (WSTLA Foundation) is a not-for-profit corporation organized under the laws of Washington, and a supporting organization of the Washington State Trial Lawyers Association (WSTLA). WSTLA Foundation, which operates the amicus curiae program formerly operated by WSTLA, has an interest in the rights of insureds under insurance policies, Washington common law, statutory law and related administrative regulations.

II. INTRODUCTION AND STATEMENT OF THE CASE

This appeal involves the law regarding a liability insurer's obligation to defend its insured, and when a failure to defend breaches the duty of good faith the insurer owes to its insured. Here, the particular context involves an insurer's refusal to defend based upon its view of a legal issue bearing on potential coverage under the policy.

The Plaintiffs/Respondents in this case are American Best Food, Inc., d/b/a Café Arizona, and Myung Chol Seo and Hyun Heui Se-Jeong (Café Arizona). The Defendant/Petitioner is Alea London, Ltd. (Alea). The underlying facts are drawn from the Court of Appeals opinion, and the briefing of the parties. See American Best Food, Inc. v. Alea London, Ltd., 138 Wn.App. 674, 158 P.3d 119 (2007), *review granted*, 163 Wn.2d 1039 (2008); Café Arizona Supp. Br. at 4-8; Alea Supp. Br. at 2-3; Alea Pet. for Rev. at 3-8; Café Arizona Ans. to Pet. for Rev. at 3-8; Café Arizona Amended Br. at 3-9; Alea Br. at 2-10.

For purposes of this amicus curiae brief, the following facts are relevant: Café Arizona operated a nightclub and carried liability insurance through Alea. Michael Dorsey (Dorsey) sued Café Arizona after he was shot in its parking lot and sustained severe injuries. In his original complaint Dorsey alleged that negligence of Café Arizona employees, both before and after the shooting, was a proximate cause of his injuries.

Café Arizona tendered the claim to Alea, seeking indemnification and a defense. Alea refused to indemnify or defend, invoking a policy exclusion providing that “[t]his insurance does not apply to any claim arising out of ... Assault and/or Battery [assault/battery exclusion].” See Am. Best Food, 138 Wn.App. at 678. Alea maintained its refusal to defend even after Café Arizona clarified that Dorsey alleged his injuries were “exacerbated” by Café Arizona employees’ negligent conduct *after* the shooting. See id. at 680-81.¹ Alea remained steadfast in refusing to defend Café Arizona based upon its view of Washington law interpreting this type of policy exclusion as applying to all injuries claimed by Dorsey, regardless of the allegation of distinct post-assault negligent conduct. Id. at 678, 680-81. As a result of the foregoing events, Café Arizona was required to provide its own defense to the Dorsey lawsuit.

¹ Alea was advised of this refinement as to the nature of the claim both in communications from Café Arizona’s counsel and by receiving a copy of Dorsey’s amended complaint, which specifically alleged injuries sustained in the shooting were exacerbated as a result of Café Arizona employees’ negligent conduct after the shooting. See Am. Best Food at 680-81.

Alea did not initiate a declaratory judgment action to obtain a legal ruling on whether it was obligated to defend Café Arizona under the circumstances; nor did it offer to defend under a reservation of rights.

Café Arizona brought this action against Alea for declaratory relief and monetary damages, asserting that Alea breached the insurance contract in failing to defend and indemnify, committed the tort of insurance bad faith, and is liable under the CPA for violation of Washington Insurance Code (Title 48 RCW) unfair claims settlement practices regulations (Ch. 284-30 WAC). See Am. Best Food at 678-79, 692-93. On cross-motions for summary judgment, the superior court granted Alea's motion, denied Café Arizona's motion, and dismissed the action.²

The Court of Appeals, Division I, reversed and remanded. First, it held that Alea had breached its duty to defend Café Arizona because it misinterpreted Washington case law regarding the applicability of the assault/battery exclusion. It concluded that Alea had not given its insured the benefit of uncertainty in the law regarding the application of the exclusion to injuries resulting from post-assault negligence by the insured.

² There is a dispute in the briefing on the scope of the summary judgment disposition, and the issues properly before this Court on review. Café Arizona contends it is entitled on review to judgment as a matter of law on its insurance bad faith claim. See Café Arizona Ans. to Pet. for Rev. at 18-19; Café Arizona Supp. Br. at 15. On the other hand, Alea asserts that the only issue on summary judgment was whether Alea had acted in good faith as a matter of law, and that Café Arizona's argument that the superior court erred in not finding bad faith as a matter of law was raised for the first time on appeal. See Alea Reply to Ans. to Pet. for Rev. at 6 n.7.

See Am. Best Food at 682-88.³ The court found that this claim was not clearly excluded, and that as a consequence the duty to defend had been breached. See id. at 688.

The Court of Appeals next found, with respect to Alea's duty to indemnify, that the assault/battery exclusion applied to the pre-assault negligence but not the post-assault negligence, and remanded for a determination of what injuries, if any, were proximately caused by the post-assault negligence. See id. at 688-89.⁴

Regarding the issue of whether Alea had breached its duty of good faith in refusing to defend, the Court of Appeals determined that a question of fact remained regarding whether it had acted unreasonably, and remanded for determination on this issue. See id. at 689-91.⁵

Lastly, the court concluded that Café Arizona had not demonstrated a triable issue of fact on whether Alea's investigation of the claim violated WAC 284-30-330(3), thereby subjecting it to potential CPA liability. See id. at 692-93. It reasoned:

However, it was Alea's legal opinion that its policy clearly excluded Café Arizona's liability to Dorsey that led to Alea's refusal to defend. Café Arizona has not shown that, given

³ The Court of Appeals' legal analysis regarding the duty to defend is principally drawn from this Court's opinion in Truck Ins. Exch. v. VanPort Homes, Inc., 147 Wn.2d 751, 58 P.3d 276 (2002). See Am. Best Food at 682-83. Notably, the court's opinion was issued before this Court's opinions in Woo v. Fireman's Fund Ins. Co., 161 Wn.2d 43, 164 P.3d 454 (2007), and Mut. of Enumclaw v. Paulson Constr., 161 Wn.2d 903, 169 P.3d 1 (2007), both of which dealt with the duty to defend and are discussed in §V, infra.

⁴ This result was apparently based upon the court's assessment of Washington case law and other out-of-state precedent discussed in the course of resolving the duty to defend issue. See Am. Best Food at 682-89.

⁵ The court left open the question of whether, if bad faith was established on remand, Café Arizona would be entitled to the remedy of coverage by estoppel. See Am. Best Food at 691-92.

Alea's legal conclusion, further investigation of factual materials would have led Alea to a different understanding of the facts or a different result. Accordingly, Café Arizona's evidence does not give rise to an inference that Alea's investigation of the facts was insufficient, or that it violated insurance settlement regulations or Consumer Protection Act provisions.

Id. (citations & footnote omitted).

Alea petitioned this Court for review, and Café Arizona sought conditional cross-review on additional issues, only if Alea's petition for review was granted. See Alea Pet. for Rev. at 2; Café Arizona Ans. to Pet. for Rev. at 17-19. This Court granted review, without limitation. See Order (June 4, 2008).

III. ISSUES PRESENTED

1. May a liability insurer refuse to defend its insured based upon its interpretation of an unresolved and reasonably debatable issue of law bearing on potential coverage?
2. If an insurer denies a duty to defend based on misinterpretation of a legal issue bearing on potential coverage, when is the denial deemed a breach of the duty of good faith?

IV. SUMMARY OF ARGUMENT

Re: Duty to Defend

An insurer's duty to defend is broader than its duty to indemnify. The duty to defend is a separate obligation under the insurance contract, and is based on the insured's potential for liability on the alleged claim. Only if the claim is *clearly not covered* is the insurer relieved of the duty to defend. The insurer's duty to defend applies when the complaint,

broadly construed, sets forth any conceivable basis for coverage in fact and law.

Under this complaint allegation rule, an insurer may not refuse to defend its insured based upon the insurer's view of an unresolved legal issue bearing on coverage that is reasonably debatable. The insurer must give the insured the benefit of the doubt, and fulfill its contractual obligation to provide the insured a defense. The insurer is not without options, however. In many instances, if the insurer believes it does not owe a duty to defend, it may provide a defense under a reservation of rights and seek a determination of non-coverage in a declaratory judgment action, so long as in doing so it does not prejudice the rights of the insured in the underlying litigation.

Re: Bad Faith Duty to Defend

An insurer should not be able to avoid liability for a bad faith refusal to defend based upon the mere reasonable debatability of the legal issue in question. An insurer that refuses to defend because it misinterprets a question of law bearing on potential coverage does so in good faith only if it is reasonably debatable under the law that the claim is *clearly not covered* at the time the decision not to defend is made. Otherwise, the refusal to defend is in bad faith.

The complaint allegation rule demands that the insurer's obligation to the insured be more exacting in the duty to defend context than indemnity context, where mere reasonable debatability may establish good

faith. Otherwise, there would be little incentive for an insurer to defend its insured, if reasonable debatability would allow it to deny a defense without any risk of extracontractual damages, such as coverage by estoppel.

V. ARGUMENT

Introduction.

For purposes of this brief, it is assumed that the Court of Appeals correctly held that Alea owed Café Arizona a defense because Washington law was unclear at the time regarding whether an assault and battery exclusion such as Alea's applied to a claim for damages based upon post-assault negligence. See Am. Best Food., 138 Wn.App. at 682-88.⁶

This brief addresses the scope of a liability insurer's duty to defend, and when the failure to defend is a breach of the insurer's duty of good faith. It does not address whether the insurer here breached the duty to indemnify in this case. The brief focuses on the law regarding a claim of bad faith failure to defend, when the gravamen of the claim is the insurer's refusal to defend based upon a misinterpretation of a legal issue bearing on coverage.

⁶ WSTLA Foundation also assumes that Alea is incorrect in contending the Court of Appeals erroneously resorted to out-of-state cases contrary to settled Washington case law, but instead simply used the out-of-state cases to support the reasonableness of the insured's legal argument on an unresolved issue of Washington law. See Alea Supp. Br. at 12-15; Café Arizona Pet. for Rev. at 7-8, 10-13; Café Arizona Supp. Br. at 5-13.

A.) Overview Of The Law Regarding Liability Insurers' Duty To Defend, And Insurance Bad Faith Generally.

Re: Duty to Defend

In a series of cases dating back to 1986 this Court has issued a number of opinions clarifying the nature of a liability insurer's contract-based duty to defend its insured, and how this duty differs from the insurer's separate obligation under the insurance policy to indemnify the insured for covered claims. See Mut. of Enumclaw v. Paulson Constr., 161 Wn.2d 903, 169 P.3d 1 (2007); Woo v. Fireman's Fund Ins. Co., 161 Wn.2d 43, 164 P.3d 454 (2007); Truck Ins. Exch. v. VanPort Homes, 147 Wn.2d 751, 58 P.3d 276 (2002); Hayden v. Mutual of Enumclaw, 141 Wn.2d 55, 1 P.3d 1167 (2000); Kirk v. Mt. Airy Ins. Co., 134 Wn.2d 558, 951 P.2d 1124 (1998); Safeco Ins. v. Butler, 118 Wn.2d 383, 823 P.2d 499 (1992); Tank v. State Farm Fire & Cas. Co., 105 Wn.2d 381, 715 P.2d 1133 (1986). The metes and bounds of the insurer's duty to defend are fairly well established, as are the organizing principles underlying this duty.

An insured's right to a defense provided by the liability insurer in third-party litigation is one of the "main benefits" of the insurance policy. Butler, 118 Wn.2d at 392. This entitlement may prove to be of greater benefit to the insured than indemnity. See Truck Ins., 147 Wn.2d at 765. Recently, in Woo this Court described the principal features of the duty to defend and its underpinnings, and contrasted it with the insurer's duty to indemnify:

The duty to defend “arises at the time an action is first brought, and is based on *the potential for liability*.” An insurer has a duty to defend “when a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy’s coverage. An insurer is not relieved of its duty to defend unless the claim alleged in the complaint is “clearly not covered by the policy.” Moreover, if a complaint is ambiguous, a court will construe it liberally in favor of “triggering the insurer’s duty to defend.” In contrast, the “duty to indemnify” hinges on the insured’s *actual liability* to the claimant and *actual coverage* under the policy. In sum, the duty to defend is triggered if the insurance policy conceivably covers the allegations in the complaint, whereas the duty to indemnify exists only if the policy *actually covers* the insured’s liability.

161 Wn.2d at 52-53 (citations & footnote omitted). Under this general construct, hereinafter referred to as the “complaint allegation rule,” the insurer must give the insured the benefit of the doubt in determining whether it owes a defense. Compliance with these requirements serves to fulfill the insurer’s quasi-fiduciary obligation to its insured under the “equal consideration” rule. See Tank, 105 Wn.2d at 388; Truck Ins., 147 Wn.2d at 761.

Re: Insurance Bad Faith

An insurer that fails to provide a defense may be liable to the insured for contract-based damages to the extent any third-party judgment is within the policy limits, if it is ultimately determined the act creating liability is a covered event under the policy. See Greer v. Northwestern

Nat'l Ins. Co., 109 Wn.2d 191, 202-03, 743 P.2d 1244 (1987); Kirk, 134 Wn.2d at 561.⁷

On the other hand, if the insurer breaches its duty of good faith owed to the insured it is liable in tort, and recovery may include extracontractual damages and "coverage by estoppel." See Butler, 118 Wn.2d at 389-94; Kirk, 134 Wn.2d at 563-65. These unique common law remedies render the insurer liable for damages in excess of the policy limits, regardless of whether actual coverage would otherwise be available. Id. These remedies are imposed by the Court for policy reasons, in recognition that in their absence the insurer could act in bad faith without risking any additional damage exposure. See e.g. Butler at 394 (recognizing that the estoppel remedy "gives the insurer a strong disincentive to act in bad faith").

Under the complaint allegation rule, an insurer confronted with a situation where coverage on the underlying claim is doubtful or subject to dispute is not without resources. There is a safe harbor. As this Court has repeatedly pointed out in recent years, the insurer may defend under a "reservation of rights" and at the same time seek a declaratory judgment that it has no duty to defend under the circumstances. See Truck Ins., 147 Wn.2d at 761; Woo, 161 Wn.2d at 54; Paulson Constr., 161 Wn.2d at 914-15. In most circumstances, this approach allows the insurer to avoid

⁷ The insurer may also be liable for attorney fees in this instance. See McGreevy v. Oregon Mut. Ins. Co., 128 Wn.2d 26, 904 P.2d 731 (1995) (upholding award of *Olympic Steamship* attorney fees and costs for insurer's incorrect but good faith denial of policy benefit).

breaching its duty to defend, or risking tort liability for insurance bad faith and imposition of coverage by estoppel. Id.⁸

As indicated above, an action for insurance bad faith sounds in tort. See Butler, 118 Wn.2d at 389; Smith v. Safeco Ins. Co., 150 Wn.2d 478, 485, 78 P.3d 1274 (2003). The inquiry on whether an insurer acts in bad faith is largely a question of whether it acted reasonably under the circumstances. See Smith, 150 Wn.2d at 486 (holding bad faith requires proof the insurer acted unreasonably); see also Mulcahy v. Farmers Ins. Co., 152 Wn.2d 92, 106, 95 P.3d 313 (2004) (requiring trial on bad faith claim if there is a question regarding reasonableness of insurer's conduct); Kirk, 134 Wn.2d at 560 (recognizing bad faith may be established by proof insurer's breach was "unreasonable, frivolous, or unfounded").

Whether an insurer acted unreasonably is often a question of fact. See Smith, 150 Wn.2d at 484. For example, an insurer's alleged bad faith may be based upon its failure to conduct a reasonable investigation of the underlying facts relevant to the claim. See e.g. Truck Ins. at 757-58, 763-64 (duty to defend context); Coventry v. American States Ins. Co., 136

⁸ Where the declaratory judgment only involves a question of law, as in this case, the action should be able to be resolved expeditiously by a court. See CR 57 (regarding declaratory judgments).

There are some fact questions bearing on coverage that cannot be resolved in a declaratory judgment action. See e.g. Holland America Ins. v. National Indemn., 75 Wn.2d 909, 912-15, 454 P.2d 383 (1969) (requiring coverage-related issue of whether driver using vehicle with permission be resolved in underlying tort litigation); Mutual of Enumclaw v. Paulson Constr., 161 Wn.2d at 914-15 (commenting on limited use of declaratory judgment action for resolving some factual matters). Further, the insurer's pursuit of a declaratory judgment cannot otherwise prejudice the insured's defense in the underlying litigation. See Thomas V. Harris, Washington Insurance Law, §14.2 at 14-4, 14-6 (2nd ed. 2006).

Wn.2d 269, 276, 961 P.2d 933 (1998) (duty to indemnify context; bad faith conceded for purposes of appeal).

To a limited degree, this Court has also addressed the issue of bad faith when the gravamen of the claim is based upon the insurer's interpretation of a legal issue or point of law. In Kirk, the Court said:

[b]ad faith will not be found where a denial of coverage *or a failure to provide a defense* is based upon a reasonable interpretation of the insurance policy. *Transcontinental Ins. Co. v. Wash. Pub. Utils. Dists' Util. Sys.*, 111 Wn.2d 452, 470, 760 P.2d 337 (1988).

134 Wn.2d at 560 (emphasis added).

Prior to Kirk, this Court had only applied the reasonable debatability standard in an indemnification context. See Transcontinental Ins. Co., 111 Wn.2d at 454-56, 470-71 (involving insurance bad faith claim in indemnification context). The statement in Kirk should not be read as fully resolving the issue of how the reasonable debatability standard is applied in the duty to defend context. Kirk involved a federal certification, and a bad faith breach based upon a failure to defend was presumed for purposes of the opinion. See 134 Wn.2d at 562. The statement suggesting that reasonable debatability prevents a finding of bad faith in the duty to defend context is not a holding. Thus, to date, the Court has not discussed application of this reasonable debatability

standard in a case involving adjudication of a claim for bad faith refusal to defend.⁹

What the Court *has* said, in Woo, is that an insurer may not avoid defending the insured based upon its interpretation of an unresolved legal issue relevant to potential coverage under the policy. See 161 Wn.2d at 59-60. It recently explained:

An insurer is relieved of its duty to defend only if the claim alleged in the complaint is “clearly not covered by the policy.” Moreover, an ambiguous complaint must be construed liberally in favor of triggering the duty to defend.

[The insurer] is essentially arguing that an insurer may rely on its own interpretation of case law to determine that its policy does not cover the allegations in the complaint and, as a result, it has no duty to defend the insured. However, the duty to defend requires an insurer to give the insured the benefit of the doubt when determining whether an insurance policy covers the allegations in the complaint. Here, [the insurer] did the opposite - - it relied on an equivocal interpretation of case law to give *itself* the benefit of the doubt rather than its insured.

Id. at 60 (citations omitted). In Woo, the Court upheld the superior court determination that the insurer had breached its duty to defend, but did not reach the issue of whether the refusal to defend was in bad faith, as that issue was not before the Court on appeal. Id. at 50-52, 60, 68-69, 71.

This issue is presented here. Relying on Kirk, the Court of Appeals below remanded the issue of bad faith refusal to defend for trial,

⁹ This Court’s opinion in Overton v. Consol. Ins. Co., 145 Wn.2d 417, 38 P.3d 322 (2002), is cited in passing by Alea. See Alea Supp. Br. at 13 n.11; Alea Br. at 38. Overton involved claims regarding the duty to indemnify and defend, and for bad faith denial of coverage and recovery under the CPA. See 145 Wn.2d at 421; id. at 435-36 (Chambers, J., dissenting). While there is some discussion of the reasonable debatability standard in the duty to defend context in the 4-justice dissent, there is no discussion of

apparently concluding that the reasonableness of Alea's misinterpretation of Washington law governing applicability of the assault/battery exclusion presented a question of fact. See Am. Best Food, 138 Wn.App. at 690. Café Arizona argues that Alea's breach of its duty to defend under the circumstances constitutes bad faith as a matter of law. See Café Arizona Supp. Br. at 15-16. Alea contends that its duty to defend determination was based upon a reasonable interpretation of the law, and thus it was acting in good faith as a matter of law. See Alea Supp. Br. at 13-14, 19 (relying on Kirk at 560-61, and Leingang v. Pierce County Med. Bureau, Inc., 131 Wn.2d 133, 155, 930 P.2d 288 (1997)).

It is necessary for this Court to now resolve the extent to which the reasonable debatability standard for bad faith developed in the indemnification context is applicable in the duty to defend context.

B.) In Light Of The Complaint Allegation Rule, An Insurer Acts In Good Faith In Refusing To Defend Based Upon A Misinterpretation Of The Law Only If It Is Reasonably Debatable The Claim Is *Clearly Not Covered*.

This Court should reject Alea's argument, based upon Kirk and Leingang, that in the duty to defend context mere debatability of a legal issue bearing on coverage establishes the insurer acted in good faith. See

this issue in the majority opinion. See id. at 424-35; id. at 435-45 (Chambers, J., dissenting).

Alea Supp. Br. at 13-14, 19.¹⁰ Any application of the reasonable debatability standard to the duty to defend context requires a slightly different analysis than where the duty to indemnify is involved. While mere reasonable debatability may prevent an insurer from being liable for insurance bad faith in the indemnity context, this should not be true in the duty to defend context, in light of the insurer's unique and heightened obligations under the complaint allegation rule.¹¹

Under this rule an insurer cannot refuse to defend unless the claim is "clearly not covered" under the policy. Kirk at 561. This standard should also dictate how insurers must view legal issues in the duty to defend context. Cf. Woo at 60 (discussing duty to defend). In the same way factual allegations in a complaint give rise to a duty to defend if "conceivably covered," Hayden, 141 Wn.2d at 64, if an insurer recognizes a pivotal legal issue is only reasonably debatable, *but cannot say it is reasonably debatable it is clearly not covered*, then a refusal to defend should constitute a breach of the insurer's duty of good faith. Otherwise, the duty to defend is undermined, as debatable issues abound in the realm of insurance. Any reasonable debatability standard in the duty to defend

¹⁰ This section of the brief presupposes the Court is inclined to follow the dicta in Kirk, suggesting the reasonable debatability standard has a place in determining whether an insurer acts in good faith in assessing an unresolved issue of law in a duty to defend context. However, the Court may determine to reexamine this approach in light of its more recent pronouncements in Truck Ins., 147 Wn.2d at 761, Woo, 161 Wn.2d at 54, and Paulson Constr., 161 Wn.2d at 914-15, and the importance the Court has placed on an insurer's opportunity to avoid bad faith liability by defending under a reservation of rights and seeking a declaratory judgment relieving it of the duty to defend.

¹¹ This Court has noted that even in the indemnity context reasonable debatability will not necessarily prevent an insurer from being liable for bad faith if its conduct is otherwise unreasonable. See Mulcahy, 152 Wn.2d at 106.

context must be more exacting. The insurer acts in good faith only if it is reasonably debatable that there is clearly no coverage under the policy.

This clarification of the language in Kirk regarding reasonable debatability is wholly consistent with the policy considerations that have dictated the stringent requirements imposed on insurers in the duty to defend context.¹² If an insurer can avoid bad faith by mere reasonable debatability of a legal question bearing on coverage, it could refuse to defend without any risk of tort liability and extracontractual damages, including coverage by estoppel. See Butler, 118 Wn.2d at 392-94. There would be little incentive for insurers to defend their insureds under these circumstances.

The standard proposed is not unduly burdensome on insurers. If anything, it may not go far enough. The insurer can avoid potential bad faith liability simply by defending under a reservation of rights and seeking immediate declaratory relief to resolve the legal issue bearing on coverage. See Paulson Constr., 161 Wn.2d at 914. The insurer has its fate in its own hands, and should be encouraged to invoke this approach.

¹² Alea's reliance on Leingang is misplaced. See Alea Supp. Br. at 14. Leingang involved whether a health care contractor was liable under the CPA for erroneously invoking an exclusion in denying first-party medical coverage. See 131 Wn.2d at 154-56. The question involved the reasonable debatability of a coverage exclusion. Id. at 155. The duty to defend was not at issue.

Of the cases cited in Leingang at 155, only one involves a duty to defend context, Smith v. Ohio Cas. Ins., 37 Wn.App. 71, 678 P.2d 829 (1984). While Smith found a breach of the duty to defend, discussion of reasonable debatability was limited to concluding that "Ohio Casualty correctly asserts mere denial of coverage due to a debatable question of coverage is not bad faith giving rise to a CPA violation." See id., 37 Wn.App. at 74. Alea also relied below on Felice v. St. Paul Fire & Marine Ins., 42 Wn.App. 352, 360-61, 711 P.2d 1066 (1985). See Alea Br. at 38-39. Felice discussed reasonable debatability only in the indemnity context.

Lastly, WSTLA Foundation disagrees with the Court of Appeals determination that the issue of insurance bad faith must be remanded here because a question of fact exists whether the insurer's refusal to defend was "unreasonable" under the circumstances. See Am. Best Food, 138 Wn.App. at 689-90. Unless it is reasonably debatable that the Dorsey claim was clearly not covered under the policy, Alea should be found to have acted in bad faith as a matter of law.

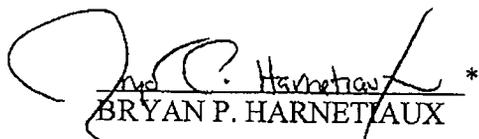
While reasonableness of an insurer's conduct is frequently a question of fact, this is not always true. For example, this Court has imposed bad faith as a matter of law where the insurer violated a specific legal obligation to its insured. See e.g. Paulson Constr., 161 Wn.2d at 914-19 (holding that, in a duty to defend context, the insurer acted in bad faith in subpoenaing the arbitrator in the underlying third-party claim); Ellwein v. Hartford Co., 142 Wn.2d 766, 782, 15 P.3d 640 (2001) (concluding insurer committed bad faith as matter of law by misappropriating insured's expert witness), *overruled in part on other grounds*, Smith v. Safeco Ins. Co., 150 Wn.2d 478, 78 P.3d 1274 (2003). As in Paulson Constr. and Ellwein, the issue here appears to be one of law for resolution by the court. If this Court concludes it was not reasonably debatable the assault/battery exclusion clearly applied to the post-assault negligence claim, then Alea breached its duty of good faith as a matter of law.¹³

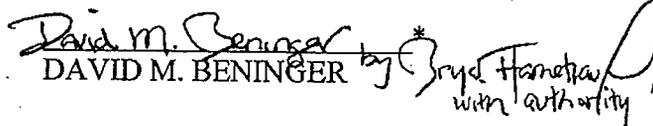
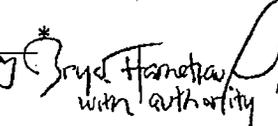
¹³ The Court of Appeals dismissed Café Arizona's CPA claim based upon violation of WAC 284-30-330(3) (recognizing unfair act or practice for failing to implement

VI. CONCLUSION

The Court should adopt the reasoning advanced in this brief and resolve the issues addressed accordingly.

DATED this 22nd day of September, 2008.


BRYAN P. HARNETAUX *


DAVID M. BENINGER by 
with authority

On Behalf of WSTLA Foundation

*Brief transmitted for filing by e-mail; signed original retained by counsel.

FILED AS
ATTACHMENT TO EMAIL

standards for prompt investigation of claims), because it concluded that "given Alea's legal conclusion" further investigation of factual matters would not have led to a different understanding of the facts or a different result. Am. Best Food, 138 Wn.App. at 692-93. This seems to ignore the fact that an insurer's investigation of a claim and potential coverage necessarily involves issues of fact *and* law. See WAC 284-30-330(13) (recognizing unfair act or practice for failing to provide reasonable explanation for denial of claim under the facts or applicable law). An insurer should not be allowed to inadequately investigate the law any more than the facts.