

BAD FAITH BLOG

To Defend or Not Defend? Issues Surrounding the Decision of the Insurer to Defend the Insured

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Summary: This case came before the federal court for the District of South Carolina upon motions to dismiss filed by Church Insurance Company of Vermont (CIC-VT) and The Church Insurance Company (CIC), and The Episcopal Church in South Carolina's (TEC-SC) motion for summary judgment. CIC-VT issued an insurance policy ("Policy") to TEC-SC. The Policy provided commercial liability coverage and other coverage, which specifically provided coverage for "advertising injury liability." After the underlying action was commenced against TEC-SC, it requested that CIC-VT defend and indemnify it. However, CIC-VT denied coverage on numerous grounds, including that the claims in the underlying action were not covered by the Policy. TEC-SC then filed suit in federal court against CIC-VT and CIC, alleging claims for: (1) breach of contract; (2) insurance bad faith; and (3) declaratory judgment that Defendants have a duty to defend and indemnify TEC-SC in the underlying action.

The Episcopal Church in South Carolina v. Church Insurance Company of Vermont and The Church Insurance Company

The underlying action was filed by Episcopal Church in the Diocese of South Carolina along with multiple break-away churches (collectively, "the Diocese") against The Episcopal Church a/k/a The Protestant Episcopal Church in the United States of America (TEC) and TEC-SC. The underlying action arose from a purported doctrinal dispute between the Diocese, TEC, and TEC-SC. Although the Diocese disassociated from TEC, the Diocese continued to use the same intellectual, real, and personal property it had used prior to the split. TEC-SC and TEC also continued to use the same intellectual, real, and personal property. Accordingly, in order to clarify the ownership of the real, personal, and intellectual property, the Diocese filed the underlying action seeking a declaration from the state court that the Diocese's existence and its continued use of the disputed property were proper. The Diocese also sought an order enjoining TEC-SC and TEC from their continued use of the same property.

In the federal court case, the court looked to South Carolina law for the standards to evaluate the insurance policy contract. South Carolina provided that insurance policies are subject to the general rules of contract construction. In South Carolina an insurer's duty to defend is based on the allegations of the underlying action and the terms of the policy.

The parties agreed that, CIC-VT's duty to defend was triggered only where an underlying action sought covered damages. Looking at the underlying action, the court held that the defined term "damages" included any monetary compensation for a person who claims to have suffered an injury. Comparing its Policy with the underlying action, the court found that CIC-VT had a duty to defend TEC-SC because the underlying action alleged both an "advertising injury" and attorneys' fees, which fell within the Policy's definition of "damages." Accordingly, the court denied CIC-VT's motion to dismiss.

The court found that TEC-SC had shown (1) the existence of a contract, (2) its breach, and (3) the damages caused by such breach. For those reasons, the court noted that where an insurer refuses to undertake the defense of an action against the insured based upon a claim within the coverage of the insurance policy, as is the case here, it thereby breaches the contract of insurance; the insurer is also liable to the insured for all damages resulting to such insured as a direct result of such refusal and breach. Therefore, the Policy issued by CIC-VT satisfied the first, second, and third elements of the breach-of-contract claim. For those reasons, the court granted TEC-SC's motion for summary judgment on its breach-of-contract claim.

Finally, the court discussed TEC-SC's insurance bad faith cause of action. In South Carolina, an insurer breaches the implied covenant of good faith and fair dealing if the following elements are shown: (1) the existence of a contract of insurance between the parties; (2) a refusal by the insurer to pay benefits due under the contract; (3) resulting from the insurer's bad faith or unreasonable action in breach of an implied covenant of good faith and fair dealing arising on the contract; (4) causing damages. In South Carolina, an insured may recover damages for a bad faith denial of coverage if the insured proves there was no reasonable basis to support the insurer's decision to deny benefits. The court concluded that TEC-SC had not presented sufficient evidence to establish that CIC-VT's refusal to defend was unreasonable or made in bad faith. Accordingly, the court denied summary judgment on TEC-SC's claim for insurance bad faith.

The insurer avoided bad faith liability in this case, but many jurisdictions are not as forgiving. Insurers must be especially aware of their duty to defend and when and how that duty arises, which differs from jurisdiction to jurisdiction. Most jurisdictions give the insured the benefit of the doubt and will find the insurer has a duty to defend even if the allegations in the complaint arguably do not trigger coverage under the policy. Therefore, insurers should educate themselves on the risks of refusing to defend, which can often be great, before sending a denial letter to the insured.

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