# A LIABILITY INSURER'S BREACH OF THE DUTY TO DEFEND AND THE CONTROVERSIAL FORFEITURE OF COVERAGE DEFENSES

DOUGLAS R. RICHMOND*



## I. INTRODUCTION

In 1886, an English insurance company issued the first liability insurance policy in the United States.[1] The importance and accessibility of liability insurance have since grown exponentially.[2] Today, most Americans and American businesses rely on liability insurance for protection against financial loss in the event they should ever be sued.[3] For example, individuals receive liability coverage under homeowners' policies, personal auto policies, and personal umbrella policies. Businesses are insured under commercial general liability (CGL) insurance policies, cyber liability policies, directors' and officers' (D&O) liability policies, employment practices liability insurance policies, and excess or umbrella policies. In some circumstances, liability insurance is compulsory or effectively mandated. For instance, states require vehicle owners to maintain specified minimum

* Managing Director, Aon, Overland Park, Kansas. J.D., University of Kansas. Opinions expressed here are the author's alone.

1. ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW 20 (6th ed. 2018).

2. As of 2017, there were 2,509 property and casualty insurers doing business in the United States. INS. INFO. INST., 2019 INSURANCE FACT BOOK v (2019). Liability insurance is a form of casualty insurance.

3. *See* Tom Baker & Kyle D. Logue, *In Defense of the Restatement of Liability Insurance Law*, 24 GEO. MASON L. REV. 767, 767 (2017) ("For most non-contractual legal claims for damages that are brought against individuals or firms, there is some form of liability insurance coverage."); Kenneth S. Abraham, *Tort Luck and Liability Insurance*, 70 RUTGERS U. L. REV. 1, 10 (2017) ("[R]oughly three-quarters of commercial and organizational defendants' potential liabilities are covered by liability insurance.").

limits of automobile liability coverage.[4] Owners who do not obey related state laws risk criminal penalties.[5] In the business context, a party to a transaction may insist that a counterparty obtain a liability insurance policy naming the first party as an additional insured as a condition of entering into the transaction.[6]

Liability insurance is essentially litigation insurance. This characterization is apt because under most primary liability insurance policies,[7] the insurance company has an express contractual duty to (1) defend the insured against lawsuits seeking specified damages;[8] and (2) indemnify the insured for covered judgments up to the policy's liability limit. Of these two duties, courts frequently describe the duty to defend as the broadest.[9] The insurer's duty to defend the insured depends on the nature of the plaintiff's claims or causes of action rather than their merit.[10] As the Illinois Supreme Court once explained, if the plaintiff's complaint or petition "alleges facts

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4. JERRY & RICHMOND, *supra* note 1, at 812-13.

5. *See, e.g.*, KAN. STAT. ANN. § 40-3104(g)(1) (2019) (making a vehicle owner's failure to provide required motor vehicle liability insurance coverage a class B misdemeanor).

6. Timothy M. Thornton, Jr., *'Additional Insured Endorsements' Can Shift Risk to Parties Not at Fault: Viewpoint*, CLAIMS J. (Apr. 30, 2019), https://www.claimsjournal.com/news/national/2019/04/30/290625.htm [https://perma.cc/NU49-22SN] (explaining additional insured coverage and observing that related contract requirements arise "in various commercial dealings").

7. A primary policy provides the first layer of insurance coverage. Primary coverage attaches immediately upon the happening of an "occurrence" or as soon as a claim is made. Ali v. Fed. Ins. Co., 719 F.3d 83, 90 (2d Cir. 2013); Haering v. Topa Ins. Co., 198 Cal. Rptr. 3d 291, 296 (Ct. App. 2016).

8. Although standard liability insurance policies typically obligate the insurer to defend the insured against "suits," and insurers routinely defend insureds in civil litigation, courts have held various other actions to be "the functional equivalent of a suit." 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 4:1, at 4-4 to -5 (6th ed. 2013). Such matters include administrative proceedings and arbitrations. *Id.* § 4:1, at 4-5 n.4 (collecting cases). Similarly, if an insurance policy obligates an insurer to defend an insured against a "claim," the insurer's duty may apply to proceedings outside of, or preparatory to, litigation. *See, e.g.*, Conduent State Healthcare, LLC v. AIG Specialty Ins. Co., No. N18C-12-074 MMJ CCLD, 2019 WL 2612829, at *6 (Del. Super. Ct. June 24, 2019) (finding the insurance company had a duty to defend an insured that had received a civil investigative demand from the Texas Attorney General).

9. *See, e.g.*, RSUI Indem. Co. v. New Horizon Kids Quest, Inc., 933 F.3d 960, 963 (8th Cir. 2019) (discussing Minnesota law and stating that a primary insurer "has both a duty to indemnify covered claims and a broader duty to defend its insured in the third party's action"); Scout, LLC v. Truck Ins. Exch., 434 P.3d 197, 202 (Idaho 2019) (explaining that an insurer's duty to defend "is much broader" than its duty to indemnify an insured); Steadfast Ins. Co. v. Greenwich Ins. Co., 922 N.W.2d 71, 79 (Wis. 2019) ("[T]he duty to defend is broader than the duty to indemnify.").

10. City of Gary v. Auto-Owners Ins. Co., 116 N.E.3d 1116, 1121 (Ind. Ct. App. 2018) (citing Trisler v. Ind. Ins. Co., 575 N.E.2d 1021, 1023 (Ind. Ct. App. 1991)); Abouzaid v. Mansard Gardens Assocs., LLC, 23 A.3d 338, 347 (N.J. 2011); Great Lakes Beverages, LLC v. Wochinski, 892 N.W.2d 333, 338 (Wis. Ct. App. 2017).

within or potentially within policy coverage, an insurer is obligated to defend its insured even if the allegations are groundless, false or fraudulent."[11]

A liability insurer's promise to defend the insured in litigation is a valuable benefit which the insured pays for as part of its premiums.[12] Indeed, the insurer's provision of a defense is "one of the principal benefits of the liability insurance policy."[13] In addition to their financial wherewithal, liability insurers have significant litigation expertise that most insureds lack.[14]

As noted above, the duty to defend attaches where there is merely the potential for coverage,[15] that is, where the plaintiff's claims or causes of action allege facts that potentially obligate the insurer to indemnify the insured should liability ultimately be established.[16] If the plaintiff pleads even one potentially covered claim or cause of action, the insurer must defend the entire matter.[17] In deciding whether an insurer owes a duty to defend, courts resolve any ambigu

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11. Gen. Agents Ins. Co. of Am. v. Midwest Sporting Goods Co., 828 N.E.2d 1092, 1098 (Ill. 2005); *see also* Hanover Ins. Co. v. Anova Food, LLC, 173 F. Supp. 3d 1008, 1020 (D. Haw. 2016) ("The insurer's duty to defend exists even if the facts alleged are untrue or the legal theories unsound.").

12. Woo v. Fireman's Fund Ins. Co., 164 P.3d 454, 459 (Wash. 2007); *see* Campbell v. Super. Ct., 52 Cal. Rptr. 2d 385, 392-93 (Ct. App. 1996) ("[I]t is undeniable that insurance is purchased to provide the peace of mind and security that comes from knowing that if the insured contingency arises, the insurer will defend against the claim. Stated another way, one of the primary benefits of an insurance policy is that the insured can expect the insurer to defend against third-party claims.").

13. *Woo*, 164 P.3d at 459-60; *see also Campbell*, 52 Cal. Rptr. 2d at 392-93 (explaining that "one of the primary benefits of an insurance policy is that the insured can expect the insurer to defend against third-party claims").

14. *See* Douglas R. Richmond, *Independent Counsel in Insurance*, 48 SAN DIEGO L. REV. 857, 877 (2011) ("Liability insurers are professional litigants."); William T. Barker, *Insurance Defense Ethics and the Liability Insurance Bargain*, 4 CONN. INS. L.J. 75, 79 (1997-1998) ("Liability insurers are in the business of managing litigation.").

15. Hartford Cas. Ins. Co. v. J.R. Mktg., L.L.C., 353 P.3d 319, 325 (Cal. 2015); Harlor v. Amica Mut. Ins. Co., 150 A.3d 793, 799 (Me. 2016) (quoting Travelers Indem. Co. v. Dingwell, 414 A.2d 220, 226 (Me. 1980)); Kiely v. Phila. Contributionship Ins. Co., 206 A.3d 1140, 1146 (Pa. Super. Ct. 2019).

16. *See* JERRY & RICHMOND, *supra* note 1, at 696.

17. Teufel v. Am. Family Mut. Ins. Co., 419 P.3d 546, 549 (Ariz. 2018); Steadfast Ins. Co. v. Greenwich Ins. Co., 922 N.W.2d 71, 79 (Wis. 2019). A case in which multiple claims are alleged against an insured but only some of which are potentially covered is often described as a mixed action. *See, e.g.*, Gonzalez v. Fire Ins. Exch., 184 Cal. Rptr. 3d 394, 403 (Ct. App. 2015) ("When a complaint states multiple claims, some of which are potentially covered by the insurance policy and some of which are not, it is a mixed action."); Fire Ins. Exch. v. Weitzel, 371 P.3d 457, 461 (Mont. 2016) ("If a complaint states multiple claims, some of which are covered by the insurance policy and some of which are not, it is a mixed action.").

ities or doubts in favor of the insured.[18] As a result, an insurer may have a duty to defend an insured even though it ultimately has no duty to indemnify the insured.[19]

In contrast to the duty to defend, an insurer's duty to indemnify the insured does not come into play until the insured's liability is established,[20] whether through settlement, summary judgment, or trial.[21] Unlike the duty to defend, the duty to indemnify requires actual coverage under the policy in question.[22]

An insurer must decide whether it has a duty to defend its insured at the outset of the litigation.[23] Depending on the jurisdiction, the insurer will decide whether to defend the insured based either on the facts alleged in the plaintiff's complaint or petition or on a combination of the facts alleged there and any extrinsic evidence known or reasonably ascertainable by the insurer.[24] If

18. *See, e.g.*, Clarke Co., Ltd. v. Am. Family Mut. Ins. Co., 914 F.3d 588, 591 (8th Cir. 2019) (applying Iowa law); Travelers Prop. Cas. Co. of Am. v. Actavis, Inc., 225 Cal. Rptr. 3d 5, 15 (Ct. App. 2017); Am. Access Cas. Co. v. Novit, 105 N.E.3d 839, 845 (Ill. App. Ct. 2018); Todd v. Vt. Mut. Ins. Co., 137 A.3d 1115, 1120 (N.H. 2016); N.C. Farm Bureau Mut. Ins. Co. v. Cox, 823 S.E.2d 613, 626 (N.C. Ct. App. 2019); Grigg v. Aarrowcast, Inc., 909 N.W.2d 183, 191 (Wis. Ct. App. 2018).

19. U-Haul Co. of Mo. v. Carter, 567 S.W.3d 680, 685 (Mo. Ct. App. 2019) (quoting Arch Ins. Co. v. Sunset Fin. Servs., Inc., 475 S.W.3d 730, 733 (Mo. Ct. App. 2015)).

20. First Mercury Ins. Co. v. Nationwide Sec. Servs., Inc., 54 N.E.3d 323, 330 (Ill. App. Ct. 2016); Bighorn Logging Corp. v. Truck Ins. Exch., 437 P.3d 287, 293 (Or. Ct. App. 2019); Choinsky v. Germantown Sch. Dist. Bd. of Educ., 926 N.W.2d 196, 203 (Wis. Ct. App. 2019).

21. McCormack Baron Mgmt. Servs., Inc. v. Am. Guar. & Liab. Ins., 989 S.W.2d 168, 173 (Mo. 1999).

22. Three Sombrero, Inc. v. Scottsdale Ins. Co., 239 Cal. Rptr. 3d 416, 420 (Ct. App. 2018) (quoting Advanced Network, Inc. v. Peerless Ins. Co., 119 Cal. Rptr. 3d 17, 23 (Ct. App. 2010)); Mt. Hawley Ins. Co. v. Casson Duncan Constr., Inc., 409 P.3d 619, 621 (Colo. App. 2016); *First Mercury Ins. Co.*, 54 N.E.3d at 330; *Bighorn Logging*, 437 P.3d at 293; Xia v. ProBuilders Specialty Ins. Co., 400 P.3d 1234, 1240 (Wash. 2017); *Choinsky*, 926 N.W.2d at 203.

23. *See* Am. & Foreign Ins. Co. v. Jerry's Sport Ctr., Inc., 2 A.3d 526, 541-42 (Pa. 2010) (explaining that the initial determination of coverage and the decision to defend are the insurer's calls to make).

24. There are two approaches to determining an insurer's duty to defend. Under the so-called four corners or eight corners approach, the factual allegations in the plaintiff's complaint or petition are compared with the policy, and the insurer owes a defense only if those allegations potentially implicate the insurer's duty to indemnify the insured. Banner Bank v. First Am. Title Ins. Co., 916 F.3d 1323, 1326-27 (10th Cir. 2019) (discussing Utah law); Lupu v. Loan City, LLC, 903 F.3d 382, 389-92 (3d Cir. 2018) (applying Pennsylvania law); *Bighorn Logging*, 437 P.3d at 293. Under this approach, facts outside the pleadings are not material to the determination of the insurer's duty to defend. *Lupu*, 903 F.3d at 390-91; GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 307 (Tex. 2006); Water Well Sols. Serv. Grp., Inc. v. Consol. Ins. Co., 881 N.W.2d 285, 294-97 (Wis. 2016). In contrast, courts employing an extrinsic evidence approach hold that an insurer must look beyond the pleadings and consider any facts brought to its attention or any facts that it reasonably could discover at the time suit was filed in deciding whether it has a duty to defend. *See, e.g.*, Atty's Liab. Prot. Soc'y, Inc. v. Ingaldson Fitzgerald, P.C., 370 P.3d

coverage is clear, the insurer will accept the insured's defense and, if necessary, indemnify the insured up to the liability limits of its policy.[25]

If the insurer's analysis of the facts presented at the outset of the litigation suggests that it may have a duty to indemnify the insured, but that its duty to do so is uncertain, the insurer typically will defend the insured under a reservation of rights. To briefly explain, an insurer that defends under a reservation of rights agrees to defend the insured while preserving its ability to later dispute coverage.[26] An insurer reserves its rights by sending the insured a reservation of rights letter.[27] Assuming the reservation of rights letter is timely issued and suitably drafted, it immunizes the insurer against allegations that it has waived coverage defenses or is estopped from asserting them by controlling the insured's defense.[28] An insurer that defends under a reservation of rights must defend

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1101, 1111-12 (Alaska 2016) ("[T]he duty to defend attaches, if at all, on the basis of the complaint and known or reasonably ascertainable facts at the time of the complaint." (footnote omitted)); Allen v. Cont'l W. Ins. Co., 436 S.W.3d 548, 553 (Mo. 2014) ("[T]he insurer's duty to defend arises only from potential coverage based on facts: (1) alleged in the petition; (2) the insurer knows at the outset of the case; or (3) that are reasonably apparent to the insurer at the outset of the case."). For courts following the extrinsic evidence approach, the allegations in the plaintiff's petition or complaint are but the starting point in analyzing the insurer's duty to defend. *See, e.g.*, McMillin Homes Constr., Inc. v. Nat'l Fire & Marine Ins. Co., 247 Cal. Rptr. 3d 825, 830 (Ct. App. 2019) ("To evaluate whether an insurer owes a duty to defend, we start by comparing the allegations of the complaint to the terms of the policy. Extrinsic facts may give rise to a duty to defend where they reveal the possibility of coverage." (citation omitted)).

25. This generally is the case. *See* JERRY & RICHMOND, *supra* note 1, at 755 ("Most claims by third parties against insureds are within policy limits and do not raise coverage questions.").

26. *See* Hoover v. Maxum Indem. Co., 730 S.E.2d 413, 416 (Ga. 2012) ("A reservation of rights is . . . designed to allow an insurer to provide a defense to its insured while still preserving the option of litigating and ultimately denying coverage."); Becker v. Bar Plan Mut. Ins. Co., 429 P.3d 212, 217 (Kan. 2018) ("Under Kansas law, the reservation of rights rule allows an insurer to assume a defense of an insured without waiving noncoverage defenses by issuing a timely notice to that person, reserving the right to question coverage and assert policy defenses."); Mastellone v. Lightning Rod Mut. Ins. Co., 884 N.E.2d 1130, 1139-40 (Ohio Ct. App. 2008) ("By definition, a reservation of rights means that the insurer does not believe that coverage is available under the policy, but that it is proceeding to defend a claim in order to control the defense.").

27. Nationwide Affinity Ins. Co. v. Laderoute, 293 F. Supp. 3d 870, 877 (W.D. Mo. 2017).

28. *See id.* ("By notifying the insured of its reservation of rights prior to any determination of liability, the insurer suspends the operation of waiver and estoppel."); Harleysville Grp. Ins. v. Heritage Cmtys., Inc., 803 S.E.2d 288, 297 (S.C. 2017) ("A reservation of rights is a way for an insurer to avoid breaching its duty to defend and seek to suspend operation of the doctrines of waiver and estoppel prior to a determination of the insured's liability.").

the insured just as competently and diligently as it would have otherwise.[29] An insurer that defends under a reservation of rights satisfies its duty to defend the insured.[30]

Finally, the insurer may be unable to ascertain any possible basis for coverage and consequently decline to defend the insured. An insurer's duty to defend, although broad, does not guarantee a defense against all allegations of wrongdoing, whatever they might be.[31] "The duty to defend does not attach where, as a matter of law, there is no basis on which the insurer may be held liable for indemnification."[32] In short, an insurer owes no duty to defend where there is no possibility of coverage.[33] An insurer may conclude that there is no possibility of coverage—meaning that it will never have to indemnify the insured—because the "occurrence" giving rise to the lawsuit against the insured is not encompassed by the policy's insuring agreement,[34] because an exclusion in the policy precludes coverage, because the insured has not satisfied a condition precedent to coverage, or even because the party requesting a defense does not qualify as an insured under the policy.[35]

If an insurer declines to defend its insured and is for some reason *wrong* about the potential for coverage, it will have breached its duty to defend. What then are the consequences of that breach? Certainly, the insurer will be liable to the insured for (1) the insured's attorney's fees and costs incurred in defending the action in the insurer's

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29. Willis Corroon Corp. v. Home Ins. Co., 203 F.3d 449, 452 (7th Cir. 2000) (applying Illinois law); Twin City Fire Ins. Co. v. Colonial Life & Accident Ins. Co., 839 So. 2d 614, 616 (Ala. 2002) (quoting Tank v. State Farm Fire & Cas. Co., 715 P.2d 1133, 1137 (Wash. 1986)).

30. *Becker*, 429 P.3d at 219; Passaic Valley Sewerage Comm'rs v. St. Paul Fire & Marine Ins. Co., 21 A.3d 1151, 1162 (N.J. 2011).

31. *See* Prime Tanning Co. v. Liberty Mut. Ins. Co., 750 F. Supp. 2d 198, 208 (D. Me. 2010) ("Although the duty to defend is broad, it is not limitless."); McMillin Homes Constr., Inc. v. Nat'l Fire & Marine Ins. Co., 247 Cal. Rptr. 3d 825, 830 (Ct. App. 2019) ("Although broad, the duty to defend is not limitless and is measured by the nature and kinds of risks covered by the policy.").

32. Zurich Am. Ins. Co. v. Ace Am. Ins. Co., 86 N.Y.S.3d 468, 469 (App. Div. 2018).

33. Pa. Nat'l Mut. Cas. Ins. Co. v. Beach Mart, Inc., 932 F.3d 268, 274-75 (4th Cir. 2019) (discussing Waste Mgmt. of Carolinas, Inc. v. Peerless Ins. Co., 340 S.E.2d 374, 378 (N.C. 1986)); All Green Elec., Inc. v. Security Nat'l Ins. Co., 231 Cal. Rptr. 3d 449, 454 (Ct. App. 2018); Spencer v. Hartford Cas., 556 S.W.3d 679, 683 (Mo. Ct. App. 2018).

34. A standard liability insurance policy defines an "occurrence" to mean "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Ins. Servs. Office, Inc., Commercial General Liability Coverage Form (CG 00 01 04 13), at 15 (2012) (on file with the author).

35. For all these same reasons, an insurer that is concerned that it cannot safely deny coverage may instead opt to defend the insured under a reservation of rights. *See* Michael Sean Quinn, *Reserving Rights Rightly: The Romance and the Temptations*, COVERAGE, July/Aug. 1997, at 23, 25 ("Insurers may reserve just about any right that would constitute an impediment to the insured's recovering under the policy.").

stead; and (2) the amount of any judgment entered against the insured, up to the policy's liability limits.[36] In some jurisdictions, the insured may be able to recover the attorney's fees it incurs in suing the insurer to enforce the insurer's duty to defend.[37] In other jurisdictions, the insured may be able to recover the full amount of any judgment entered against it, including any portion of the judgment that exceeds the policy limits,[38] although extracontractual liability for an insurer's simple breach of the duty to defend is a minority position.[39]

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36. JERRY & RICHMOND, *supra* note 1, at 716.

37. *Id.*

38. *See, e.g.*, Liberty Mut. Ins. Co. v. Metro. Life Ins. Co., 260 F.3d 54, 63 (1st Cir. 2001) (applying Massachusetts law); Newman v. United Fire & Cas. Co., 995 F. Supp. 2d 1125, 1133 (D. Mont. 2014) (noting the rule under both Utah and Montana law); McGrath v. Everest Nat'l Ins. Co., 668 F. Supp. 2d 1085, 1107-09 (N.D. Ind. 2009) (applying Indiana law); Sauer v. Home Indem. Co., 841 P.2d 176, 184 (Alaska 1992) (concluding that an insurer that breaches its duty to defend is liable for any ensuing judgment); Atlanta Cas. Ins. Co. v. Gardenhire, 545 S.E.2d 182, 184 (Ga. Ct. App. 2001) (stating that an insurer that fails to defend may be liable for the full amount of any judgment); Cincinnati Ins. Co. v. Vance, 730 S.W.2d 521, 523 (Ky. 1987) ("[I]f the insurer has elected not to provide a defense . . . the aggrieved party then would be entitled to recover all damages naturally flowing from the breach irrespective of policy limits."); Tidyman's Mgmt. Servs. Inc. v. Davis, 330 P.3d 1139, 1150 (Mont. 2014) ("[A]n insurer who breaches the duty to defend is liable for the full amount of the judgment, including amounts in excess of policy limits."); Century Sur. Co. v. Andrew, 432 P.3d 180, 182 (Nev. 2018) (deciding that an insurer's liability for breaching its duty to defend "is not capped at the policy limits plus the insured's defense costs"); Fireman's Fund Ins. Co. v. Imbesi, 826 A.2d 735, 749 (N.J. Super. Ct. App. Div. 2003) (quoting Griggs v. Bertram, 443 A.2d 163, 171-72 (N.J. 1982)); Bruce-Terminix Co. v. Zurich Ins. Co., 504 S.E.2d 574, 580 (N.C. Ct. App. 1998) (quoting Jamestown Mut. Ins. Co. v. Nationwide Mut. Ins. Co., 176 S.E.2d 751, 754 (N.C. 1970)); Blake v. Nationwide Ins. Co., 904 A.2d 1071, 1076 (Vt. 2006) (citing *Vance*, 730 S.W.2d at 522); Water Wells Sols. Serv. Grp., Inc. v. Consol. Ins. Co., 881 N.W.2d 285, 297 (Wis. 2016) (explaining that "an insurer that breaches its duty to defend is liable for all costs naturally flowing from the breach," regardless of policy limits).

39. Numerous cases express the majority view that a simple breach of the duty to defend does not expose an insurer to extracontractual liability. *See, e.g.*, Nalder v. United Auto. Ins. Co., 824 F.3d 854, 857 (9th Cir. 2016) (quoting Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 201 (Cal. 1958)); Quorum Health Res., L.L.C. v. Maverick Cty. Hosp. Dist., 308 F.3d 451, 468 (5th Cir. 2002) (applying Texas law); Liberty Mut. Fire Ins. Co. v. Canal Ins. Co., 177 F.3d 326, 336 (5th Cir. 1999) (discussing Mississippi law); Am. Safety Cas. Ins. Co. v. City of Waukegan, 776 F. Supp. 2d 670, 702 (N.D. Ill. 2011) (quoting Conway v. Country Cas. Ins. Co., 442 N.E.2d 245, 249 (Ill. 1982)); Cincinnati Ins. Co. v. Grand Pointe, LLC, 501 F. Supp. 2d 1145, 1174 (E.D. Tenn. 2007) ("Under Tennessee law an insurer which breaches its duty to defend is liable for the amount of the policy plus the reasonable costs incurred in providing a defense for its insured."); Spence-Parker v. Md. Ins. Grp., 937 F. Supp. 551, 557-58 (E.D. Va. 1996) (applying Virginia law); Quihuis v. State Farm Mut. Auto. Ins. Co., 334 P.3d 719, 730 (Ariz. 2014) (stating that if an insurer breaches its duty to defend then "the insurer must pay the damages awarded in the default judgment (at least up to the policy limits) unless it can prove fraud or collusion"); Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 67 A.3d 961, 993 (Conn. 2013) ("If the insurer declines to provide its insured with a defense and is subsequently found to have breached its duty to do so, it bears the consequences of its decision, including the payment of any reasonable settlement agreed to by the plaintiff and the insured, and the costs incurred effec-

A controversial issue is whether the insurer's breach of the duty to defend should result in the loss of any coverage defenses the insurer could otherwise assert to avoid indemnifying the insured. Phrased as a question, should an insurer that breaches its duty to defend forfeit any defenses to coverage?

From insurers' perspective, forfeiting coverage defenses for a breach of the duty to defend is an unfair penalty that ignores the different standards that govern the duty to defend and duty to indemnify; inflates insureds' claimed damages flowing from a breach of the duty to defend; unjustly enriches insureds, who receive the windfall of indemnity for a loss regardless of whether their policies cover the subject loss; encourages insureds to set up insurers for breach of contract and bad faith claims through various forms of "gamesmanship"; and potentially offends public policy where, for example, an insurer might be barred from asserting a policy exclusion for expected or intended harm.[40] Insurers also argue that the forfeiture-of-coverage-defenses rule is unnecessary given the availability and effectiveness of existing remedies for breach of the duty to defend.[41]

Proponents of the forfeiture-of-coverage-defenses rule, on the other hand, contend that it properly aligns insurers' interests with

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tuating the settlement up to the limits of the policy."); State Farm Mut. Auto. Ins. Co. v. Horkheimer, 814 So. 2d 1069, 1071 (Fla. 4th DCA 2001) ("Absent a showing of bad faith, a judgment cannot be entered against an insurer in excess of its policy limits."); Colonial Oil Indus. Inc. v. Underwriters Subscribing to Policy Nos. TO31504670 & TO31504671, 491 S.E.2d 337, 339 (Ga. 1997) ("[W]hen the insurer breaches the contract by wrongfully refusing to provide a defense, the insured is entitled to receive only what it is owed under the contract—the cost of defense. The breach of the duty to defend, however, should not enlarge indemnity coverage beyond the parties' contract."); Johnson v. Westhoff Sand Co., 62 P.3d 685, 699 (Kan. Ct. App. 2003) ("[A]n insurer who wrongfully refuses to defend an action against its insured is not liable for the amount of a judgment in excess of policy limits, absent a showing by the insured that the excess judgment is traceable to the refusal to defend."); Mesmer v. Md. Auto. Ins. Fund, 725 A.2d 1053, 1064 (Md. 1999) ("[T]he damages for breach of the contractual duty to defend are limited to the insured's expenses, including attorney fees, in defending the underlying tort action, as well as the insured's expenses and attorney fees in a separate contract or declaratory judgment action if such action is filed to establish that there exists a duty to defend."); Engeldinger v. State Auto. & Cas. Underwriters, 236 N.W.2d 596, 602 (Minn. 1975) (reaffirming the rule announced years earlier); Allen v. Bryers, 512 S.W.3d 17, 38 (Mo. 2016) (quoting Landie v. Century Indem. Co., 390 S.W.2d 558, 562 (Mo. Ct. App. 1965)); Gedeon v. State Farm Mut. Auto. Ins. Co., 188 A.2d 320, 322 (Pa. 1963) (reasoning that an insured's damages for breach of the duty to defend are limited to the cost of hiring substitute counsel and other defense costs); Waite v. Aetna Cas. & Sur. Co., 467 P.2d 847, 851 (Wash. 1970) (stating that where an insurer wrongfully refuses to defend, it must pay the judgment or settlement up to its policy limits and reimburse the insured's reasonable defense costs).

40. Laura A. Foggan & Karen L. Toto, *The Draft ALI Restatement of the Law of Liability Insurance: Consequences of Breach of the Duty to Defend are Not and Should Not Become the Automatic Forfeiture of Coverage Defenses*, 68 RUTGERS U.L. REV. 65, 66-67 (2015).

41. *Id.* at 76-77.

insureds' interests by forcing an insurer to assume an insured's defense in cases in which the potential for coverage is questionable.[42] In contrast, a rule that allows an insurer to wrongly refuse to defend an insured and still preserve its coverage defenses effectively encourages the insurer to deny a defense when coverage is doubtful.[43] Furthermore, stripping a breaching insurer of its coverage defenses is consistent with the rule that an insurer that knows of coverage defenses at the outset of litigation against its insured but does not reserve its rights to contest coverage when it assumes the insured's defense is estopped from later disputing coverage.[44] "An insurer [that] erroneously fails to provide any defense at all should not have greater rights to contest coverage," the argument goes.[45]

These competing positions came to the forefront during the American Law Institute's (ALI) preparation of the new Restatement of the Law of Liability Insurance (the Restatement).[46] As initially drawn, Section 19 of the Restatement, titled "Consequences of the Breach of the Duty to Defend,"[47] provided that an insurer that breached the duty to defend would lose "the right to contest coverage for the claim."[48] This position provoked howls of protest from the insurance industry,[49] whose members considered the Restatement approach to this

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42. *See* Jeffrey W. Stempel, *Enhancing the Socially Instrumental Role of Insurance: The Opportunity and Challenge Presented by the ALI Restatement Position on Breach of the Duty to Defend*, 5 U.C. IRVINE L. REV. 587, 602 (2015) (quoting PRINCIPLES OF THE LAW OF LIABILITY INSURANCE § 21 (AM. LAW INST. Tentative Draft No. 2, 2014)).

43. *See id.* (quoting PRINCIPLES OF THE LAW OF LIABILITY INSURANCE § 21 (AM. LAW INST. Tentative Draft No. 2, 2014)).

44. *Id.* at 602-603.

45. *Id.* at 603.

46. In the interest of disclosure, I am an elected ALI member and was an Adviser to the Restatement project from its inception.

47. A Restatement is developed through a series of drafts prepared by the project's Reporters for review by various ALI constituencies. *See* AM. LAW INST., THE AMERICAN LAW INSTITUTE: A HANDBOOK FOR ALI REPORTERS AND THOSE WHO REVIEW THEIR WORK 15-19 (Rev. ed. 2015) [hereinafter ALI STYLE MANUAL] (outlining the Restatement drafting process).

48. RESTATEMENT OF THE LAW OF LIAB. INS. § 19(1) (AM. LAW INST., Discussion Draft, 2015).

49. Among other criticisms, insurance company representatives faulted the Reporters' tentative embrace of the forfeiture-of-coverage-defenses rule on the basis that the ALI was adopting a minority view. *See, e.g.*, Foggan & Toto, *supra* note 40, at 68 ("Far from restating or describing the law, the section of the Restatement concerning 'Consequences of the Breach of the Duty Defend' adopts a distinct minority view." (footnote omitted)). To be sure, the potential adoption of a minority position in any legal context should be cause for reflection. The ALI, however, does not require Reporters to adhere to majority rules. Rather, "[w]hen decisions among state courts conflict, a Reporter should report the conflict but is not bound to adhere to the majority view. Reporters are expected to recommend to the Institute what they believe to be the better rule or the better formulation of a rule." ALI STYLE MANUAL, *supra* note 47, at 7.

and other issues "unnecessarily prejudicial to insurers and in tension with a number of established common law insurance rules."[50] For insurers, the ALI's initial embrace of the forfeiture-of-coverage-defenses rule for breach of the duty to defend was a "flashpoint."[51]

The ALI modified the forfeiture-of coverage-defenses rule in a subsequent draft of the Restatement.[52] As revised, Section 19 provided: "An insurer that breaches the duty to defend without a reasonable basis for its conduct must provide coverage for the legal action for which the defense was sought, notwithstanding any grounds for contesting coverage that the insurer could have preserved by providing a proper defense under a reservation of rights" pursuant to another Restatement section.[53] This revision reflected "a middle ground" between the forfeiture-of-coverage-defenses rule and the alternative approach that allows an insurer that breaches its duty to defend to retain its coverage defenses.[54]

The Restatement ultimately rejected the forfeiture-of-coverage-defenses rule in instances of simple breach in favor of the majority rule, meaning that an insurer that mistakenly breaches the duty to defend retains the right to contest coverage.[55] Section 19 now provides: "An insurer that breaches the duty to defend a legal action forfeits the right to assert any control over the defense or settlement of the action."[56] Importantly, however, the Restatement retained the forfeiture-of-coverage-defenses rule as a possible remedy where the insurer breaches its duty to defend in bad faith.[57]

The controversy over the forfeiture-of-coverage-defenses rule will not end with the Restatement's publication. However influential Restatements may be, they are not controlling law in any jurisdiction. In fact, several states have passed legislation that in some fashion condemns or limits courts' reliance on the Restatement, while others have passed resolutions opposing positions taken in the

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50. Foggan & Toto, *supra* note 40, at 65.

51. *Id.*

52. RESTATEMENT OF THE LAW OF LIAB. INS. § 19(2) (AM. LAW INST., Tentative Draft No. 1, 2016).

53. *Id.*

54. *Id.* § 19 cmt. c. This approach also was said to be "consistent with the majority rule that supports an award to insureds of remedies that go beyond ordinary contract damages . . . when insurers breach in bad faith. The objective, no reasonable-basis standard . . . is one of the leading standards for what constitutes a bad-faith breach."

55. *See infra* Part III.A.

56. RESTATEMENT OF THE LAW OF LIAB. INS. § 19 (AM. LAW INST. 2019).

57. *See id.* cmt. c ("[A]n insurer that breaches the duty to defend may lose its coverage defenses only if the breach was in bad faith. . . ."); *id.* § 50(2) (providing as a remedy for bad faith "[o]ther remedies as justice requires"); *id.* § 50 cmt. c ("The loss-of-coverage-defense remedy is particularly appropriate when an insurer refuses to defend in bad faith.").

Restatement on the basis that the Restatement supposedly upends settled insurance law.[58] The forfeiture-of-coverage-defenses rule reflects the law in a number of jurisdictions, whether linked to mistaken breaches of the duty to defend or instances of bad faith.[59] Courts in other jurisdictions have yet to consider the issue and may well adopt the forfeiture-of-coverage-defenses rule notwithstanding the Restatement's ultimate rejection of that approach, and some leading insurance scholars favor the forfeiture-of-coverage-defenses rule. For that matter, courts that have previously rejected the forfeiture-of-coverage-defenses rule and thus allowed breaching insurers to retain their coverage defenses may reconsider that position when presented with seemingly persuasive cases for change.[60]

This article examines the coverage consequences of an insurer's breach of the duty to defend though a practical lens. It begins in Part II by discussing courts' use of the term "estoppel" to describe insurers' loss of coverage defenses following a breach of the duty to defend. In fact, estoppel in any true doctrinal sense is missing from courts' analysis of the consequences of insurers' breach of the duty to defend.[61] As explained below, courts' use of estoppel in this context is shorthand for an equitable remedy for breach of an insurance contract. Part III discusses the competing positions on the consequences of an insurer's breach of its duty to defend. These are (a) the majority rule, which holds that an insurer that mistakenly breaches its duty to defend an insured may thereafter contest coverage; (b) the minority forfeiture-of-coverage-defenses rule, which, as the name indicates,

58. Lucian McMahon, *Pushback Continues Against ALI Restatement of Liability Insurance*, INS. INFO. INST.: TRIPLE-I BLOG (May 10, 2019), https://www.iii.org/insuranceindustryblog/pushback-continues-restatement-liability-insurance [https://perma.cc/2SSH-MRV2] (identifying Arkansas, Michigan, North Dakota, Ohio, Tennessee, and Texas as having passed legislation condemning or limiting the use of the Restatement when deciding cases under their insurance common law and noting that the Kentucky and Indiana legislatures have passed resolutions opposing the Restatement). These initiatives apparently were encouraged or promoted by segments of the insurance industry in a campaign to diminish the possible influence of those portions of the Restatement that those industry members considered excessively pro-policyholder.

59. *See infra* Part III.B.

60. Lest anyone doubt that courts may change their minds, consider the recent New York experience in which the state's highest court first embraced the forfeiture-of-coverage-defenses rule and then reversed itself one year later. *Compare* K2 Inv. Grp., LLC v. Am. Guarantee & Liab. Ins. Co. (*K2-I*), 993 N.E.2d 1249, 1251 (N.Y. 2013) ("We hold that, when a liability insurer has breached its duty to defend its insured, the insurer may not later rely on policy exclusions to escape its duty to indemnify the insured for a judgment against him."), *with* K2 Inv. Grp., LLC v. Am. Guarantee & Liab. Ins. Co., 6 N.E.3d 1117, 1120-21 (N.Y. 2014) (vacating the decision in *K2-I* even though there was "much to be said for the rule in *K2-I*").

61. *See, e.g.*, Polaroid Corp. v. Travelers Indem. Co., 610 N.E.2d 912, 922 (Mass. 1993) (recognizing this analytical flaw).

holds that an insurer that simply breaches its duty to defend loses the right to contest coverage; and (c) what might be described as a middle ground position, which holds that an insurer forfeits its right to dispute coverage only if it breaches its duty to defend in bad faith. Finally, as likely will be apparent from the discussion in Part III, Part IV concludes that while the forfeiture-of-coverage-defenses rule and the middle ground approach have superficial appeal, they are materially flawed. The majority rule, which allows an insurance company that breaches its duty to defend to nonetheless contest coverage, is superior.

## II. AN INITIAL WORD ON THE AWKWARD USE OF ESTOPPEL TERMINOLOGY

In discussing insurers' loss of coverage defenses as a consequence of their breach of the duty to defend, courts often describe the insurer's breach as estopping it from disputing coverage.[62] Similarly, courts that reject the forfeiture-of-coverage-defenses rule often refer to estoppel in the process.[63] Unfortunately, courts in both camps "have used the term estoppel loosely and even erroneously."[64] Certainly, courts analyzing the consequences of an insurer's breach of the duty to defend generally do not specify what form of the doctrine they are referring to or relying on in holding as they do.[65] For example, they typically do not refer to or distinguish between collateral estoppel (which requires the actual litigation of issues necessary to a judicial determination and is alternatively referred to as issue preclusion), equitable estoppel (which requires conduct or a statement inducing reasonable detrimental reliance), promissory

62. *See, e.g.*, Title Indus. Assur. Co., R.R.G. v. First Am. Title Ins. Co., 853 F.3d 876, 880 (7th Cir. 2017) ("Under Illinois law, when a liability insurer unjustifiably refuses to defend a suit against its insured, the insurer will be estopped from later asserting policy defenses to coverage."); *In re* Abrams & Abrams, P.A., 605 F.3d 238, 241 (4th Cir. 2010) ("Under North Carolina law, if an insurer improperly refuses to defend a claim, it is estopped from denying coverage. . . ."); Lloyd's & Inst. of London Underwriting Cos. v. Fulton, 2 P.3d 1199, 1209 (Alaska 2000) ("[A]n insurer's breach of the duty to defend must be considered a material breach that estops denial of coverage unless the breach clearly has no adverse impact on the relationship between the insurer and the insured.").

63. *See, e.g.*, G.M. Sign, Inc. v. St. Paul Fire & Marine Ins. Co., 768 F. App'x 982, 989 (11th Cir. 2019) ("[U]nder Georgia law, an insurer that wrongfully denies a duty to defend is not estopped from later contesting coverage."); Ala. Hosp. Ass'n Tr. v. Mut. Assur. Soc'y of Ala., 538 So. 2d 1209, 1216 (Ala. 1989) ("A failure of an insurer to defend a claim against an insured does not work an estoppel on the issue of coverage."); Hirst v. St. Paul Fire & Marine Ins. Co., 683 P.2d 440, 447 (Idaho Ct. App. 1984) ("We question the propriety of utilizing a form of estoppel as a punitive measure against an insurer for breach of a contractual duty to defend.").

64. Stempel, *supra* note 44, at 605 (footnote omitted).

65. *Id.*

estoppel (which refers to the enforcement of a promise in the absence of consideration where the promisee detrimentally relied on the promise), judicial estoppel (which sometimes prevents a party from arguing inconsistent positions in a proceeding), or legal estoppel (which refersto an estoppel recognized in law).[66] These failures have caught observant courts' attention. For instance, the Massachusetts Supreme Court has characterized courts' use of the term estoppel when stripping a breaching insurer of its coverage defenses as "a conclusion" that "fails to recognize that no estoppel is involved in any traditional sense."[67]

In fact, courts that have adopted the forfeiture-of-coverage-defenses rule for breach of the duty to defend have simply concluded that the insurer's loss of its coverage defenses is "a logical and fair consequence of the breach on both doctrinal and policy grounds."[68] At bottom, then, courts' reference to estoppel in this context is shorthand for an equitable remedy for the insurer's breach of contract. Were that not the case, invoking estoppel to prevent an insurer from asserting coverage defenses after breaching its duty to defend would violate the oft-stated principle that estoppel generally cannot be used to create coverage that does not otherwise exist under the policy.[69]

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66. *Id.* at 606-07.

67. Polaroid Corp. v. Travelers Indem. Co., 610 N.E.2d 912, 922 (Mass. 1993).

68. Stempel, *supra* note 44, at 606.

69. *See, e.g.*, Elec. Motor & Contracting Co. v. Travelers Indem. Co. of Am., 235 F. Supp. 3d 781, 794 (E.D. Va. 2017) (applying Virginia law and discussing estoppel); Komorsky v. Farmers Ins. Exch., 245 Cal. Rptr. 3d 623, 633 (Ct. App. 2019) (noting the general rule that coverage cannot be created by estoppel); Noble v. Wellington Assocs., Inc., 145 So. 3d 714, 721 (Miss. Ct. App. 2013) (explaining that estoppel cannot expand coverage); Deardorff v. Farnsworth, 343 P.3d 687, 691 (Or. Ct. App. 2015) ("Typically, estoppel is available to avoid a condition of forfeiture, but it is not available to avoid an express exclusion; that is, it cannot expand the scope of an insurance contract."); Maxwell v. Hartford Union High Sch. Dist., 814 N.W.2d 484, 492 (Wis. 2012) ("Waiver and estoppel cannot be used to supply coverage from the insurer to protect the insured against risks not included in the policy or expressly excluded therefrom, for that would force the insurer to pay a loss for which it has not charged a premium."). *But see* Quincy Mut. Fire Ins. Co. v. Imperium Ins. Co., 636 F. App'x 602, 606 (3d Cir. 2016) (explaining that to establish coverage by estoppel, the insured must have reasonably and detrimentally relied on the insurer's misstatement that coverage existed); Liberty Mut. Fire Ins. Co. v. Clemens Coal Co., 250 F. Supp. 3d 825, 833 (D. Kan. 2017) (stating that under Kansas law, estoppel may create coverage "where (1) there were affirmative representations and acts of coverage; and (2) the policy did not explicitly exclude coverage").

## III. EXAMINING THE COMPETING POSITIONS

### *A. The Majority Approach Preserving an Insurer's Coverage Defenses*

Regardless of the terminology used—estoppel versus forfeiture—most courts that have considered the issue have concluded that an insurer that breaches its duty to defend may nonetheless contest coverage when sued for the breach.[70] The majority approach first re-

70. *See, e.g.*, G.M. Sign, Inc. v. St. Paul Fire & Marine Ins. Co., 768 F. App'x 982, 989 (11th Cir. 2019) ("[U]nder Georgia law, an insurer that wrongfully denies a duty to defend is not estopped from later contesting coverage."); Scottsdale Ins. Co. v. Byrne, 913 F.3d 221, 231 (1st Cir. 2019) (applying Massachusetts law and stating that it is the insurer's burden to prove the lack of coverage); Morales v. Zenith Ins. Co., 714 F.3d 1220, 1227 (11th Cir. 2013) (applying Florida law); Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., Inc., 304 F.3d 804, 807 (8th Cir. 2002) (applying Missouri law); Capital Envtl. Servs., Inc. v. N. River Ins. Co., 536 F. Supp. 633, 645 (E.D. Va. 2008) (interpreting Virginia law and quoting W. Alliance Ins. Co. v. N. Ins. Co. of N.Y., 176 F.3d 825 (5th Cir. 1999)); Ala. Hosp. Ass'n Tr. v. Mut. Assur. Soc'y of Ala., 538 So. 2d 1209, 1216 (Ala. 1989) ("A failure of an insurer to defend a claim against an insured does not work an estoppel on the issue of coverage."); Quihuis v. State Farm Mut. Auto. Ins. Co., 334 P.3d 719, 727-29 (Ariz. 2014) (rejecting the insureds' argument that the insurer's breach of its duty to defend prevented it from disputing coverage); DeWitt v. Monterey Ins. Co., 138 Cal. Rptr. 3d 705, 720 n.17 (Ct. App. 2012) (citing Hogan v. Midland Nat'l Ins. Co., 476 P.2d 825, 832 (Cal. 1970)); McGowan v. State Farm Fire & Cas. Co., 100 P.3d 521, 527 (Colo. App. 2004) (agreeing with the majority rule that a breach of the duty to defend does not preclude an insurer from contesting its duty to indemnify); Delmonte v. State Farm Fire & Cas. Co., 975 P.2d 1159, 1172 (Haw. 1999) (rejecting the plaintiffs' equitable estoppel argument); Hirst v. St. Paul Fire & Marine Ins. Co., 683 P.2d 440, 447 (Idaho Ct. App. 1984) (rejecting estoppel as a remedy for a breach of the duty to defend in favor of "ordinary principles of contract law."); Gilmore v. Beach House, Inc., 174 P.3d 439, 444-45 (Kan. Ct. App. 2008) (quoting Aselco, Inc. v. Hartford Ins. Grp., 21 P.3d 1011, 1020 (Kan. Ct. App. 2001)); Cincinnati Ins. Co. v. Vance, 730 S.W.2d 521, 523 (Ky. 1987) (disagreeing with the proposition that an insurer's breach of the duty to defend estops it from litigating coverage); Arceneaux v. Amstar Corp., 66 So. 3d 438, 452 (La. 2011) (stating that a breach of the duty to defend "is determined by ordinary contract law principles and the insurer is liable for the insured's reasonable defense costs"); Harlor v. Amica Mut. Ins. Co., 150 A.3d 793, 801-02 (Me. 2016) (reciting its position that an insurer that breaches its duty to defend does not lose the right to contest coverage, but it is the insurer's burden to prove a lack of coverage); Mesmer v. Md. Auto. Ins. Fund, 725 A.2d 1053, 1058 (Md. 1999) (limiting damages for breach of the duty to defend to the policy limits and payment of defense costs); A.B.C. Builders, Inc. v. Am. Mut. Ins. Co., 661 A.2d 1187, 1191 (N.H. 1995) ("An insurer's breach, however, should not be used as a method of obtaining coverage . . . that the insured did not purchase. . . . The relief afforded must bear a reasonable relation to the liability covered and the damages indemnified." (citations omitted)); K2 Inv. Grp., LLC v. Am. Guarantee & Liab. Ins. Co., 6 N.E.3d 1117, 1120-21 (N.Y. 2014) (reconsidering its prior decision and retreating from the forfeiture-of-coverage-defenses rule); Medd v. Fonder, 543 N.W.2d 483, 487 (N.D. 1996) (rejecting the insured's estoppel argument); Nw. Pump & Equip. Co. v. Am. States Ins. Co., 925 P.2d 1241, 1244 (Or. Ct. App. 1996) (concluding "that an insurer's breach of the duty to defend does not give rise to a duty to indemnify unless the underlying claim is covered"); Am. States Ins. Co. v. State Auto. Ins. Co., 721 A.2d 56, 64 (Pa. Super. Ct. 1998) ("[W]e will not adopt a blanket rule that if there is a breach of a duty to defend . . . then it automatically requires the breaching insurer to indemnify. . . . [A] duty to indemnify requires an inquiry into whether

spects the rule that the duty to defend and duty to indemnify are separate and distinct obligations.[71] As a result, they must be analyzed independently.[72]

To repeat, the duty to defend turns on the potential for coverage, whether based on the factual allegations in the plaintiff's complaint or petition, or on a combination of the facts alleged there in combination with any extrinsic evidence known or reasonably ascertainable by the insurer.[73] In contrast, the duty to indemnify pivots on the insured's actual liability, whether established by way of settlement, summary judgment, or trial.[74] The breach of the former duty does not establish the breach of the latter.[75] The forfeiture-of-coverage-defenses rule, however, overrides these important differences. It effectively combines the standards for breach of the duty to defend and breach of the duty to indemnify into one. The majority rule properly rejects this blending.[76]

Second, and perhaps more importantly, preserving the insurer's ability to contest coverage following a mistaken breach of the duty to defend recognizes that insurance policies are contracts and that an insurer's simple breach of its duty to defend is but a breach of contract.[77] Of course, fundamental contract law holds that damages for

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there was actual coverage for the underlying claim. The recovery for breaching a duty to defend is to require the breaching insurer to pay for costs of defense."); Evanston Ins. Co. v. ATOFINA Petrochems., Inc., 256 S.W.3d 660, 674 n.74 (Tex. 2008) (citing Utica Nat'l Ins. Co. v. Am. Indem. Co., 141 S.W.3d 198, 203 (Tex. 2004)). Indiana appears to have cases adopting both the majority and minority approaches. *Compare* Grinnell Mut. Reinsurance Co. v. Ault, 918 N.E.2d 619, 625 (Ind. Ct. App. 2009) ("[A]n insurer's failure to defend an insured or seek a declaratory judgment does not waive its coverage defenses."), *with* City of Gary v. Auto-Owners Ins. Co., 116 N.E.3d 1116, 1120-21 (Ind. Ct. App. 2018) (noting that where an insurer has a duty to defend and does not either defend under a reservation of rights or file a declaratory judgment action to determine its obligations, it will be estopped from raising policy defenses to coverage).

71. Allegis Inv. Servs., LLC v. Arthur J. Gallagher & Co., 371 F. Supp. 3d 983, 994 (D. Utah 2019) (quoting Aspen Specialty Ins. Co. v. Utah Local Gov'ts Tr., 954 F. Supp. 2d 1311, 1315 (D. Utah 2013)); Advanced Sys., Inc. v. Gotham Ins. Co., 272 So. 3d 523, 526 (Fla. 3d DCA 2019); S. Tr. Ins. Co. v. Mountain Express Oil Co., 828 S.E.2d 455, 458 (Ga. Ct. App. 2019); Arch Ins. Co. v. Sunset Fin. Servs., Inc., 475 S.W.3d 730, 733 (Ct. App.

72. Bighorn Logging Corp. v. Truck Ins. Exch., 437 P.3d 287, 293 (Or. Ct. App. 2019); Gull Indus., Inc. v. State Farm Fire & Cas. Co., 326 P.3d 782, 786 (Wash. Ct. App. 2014).

73. *See supra* note 24 and accompanying text.

74. *See supra* note 20 and accompanying text.

75. *Nw. Pump & Equip. Co.*, 925 P.2d at 1243.

76. *Id.* at 1244.

77. *See* Arceneaux v. Amstar Corp., 66 So. 3d 438, 452 (La. 2011) (stating that an insurer's breach of the duty to defend is "determined by ordinary contract law principles"); Mesmer v. Md. Auto. Ins. Fund, 725 A.2d 1053, 1059 (Md. 1999) ("[W]hen the dispute is over the existence of any valid contractual obligation covering a particular matter, or where the defendant has failed to recognize or undertake any contractual obligation whatsoever, the plaintiff is ordinarily limited to a breach of contract remedy.").

breach are intended to restore the injured party to the position it would have enjoyed had the breaching party instead fulfilled its obligations.[78] The injured party "is entitled to be made whole, but not more than whole."[79] In other words, the injured party is not entitled to be placed in a better position than it would have occupied had there been no breach.[80] The injured party is not permitted a windfall.[81]

Holding that an insurer that mistakenly breaches its duty to defend surrenders the ability to challenge coverage puts the insured in a better position than it would have occupied had there been no breach. After all, had the insurer defended the insured under a reservation of rights and ultimately established that it had no duty to indemnify the insured, the insured—not the insurer—would be responsible for paying any adverse judgment in the case.[82] The forfeiture-of-coverage-defenses rule thus grants the insured a windfall in the form of coverage that it was not contractually owed.[83] Similarly, consider a mixed action that the insurer mistakenly declines to defend.[84] If it turns out that one of the claims is covered and the other is not, the insurer's loss of its coverage defenses as a consequence of its breach means the insurer must indemnify the insured in connection with the uncovered claim.[85] Again, the insured receives a windfall in

78. Legacy Data Access, Inc. v. Cadrillion, LLC, 889 F.3d 158, 168 (4th Cir. 2018) (applying North Carolina law); Brookewood, Ltd. P'ship v. DeQueen Physical Therapy & Occupational Therapy, Inc., 547 S.W.3d 461, 467 (Ark. Ct. App. 2018); WSC/2005 LLC v. Trio Venture Assocs., 190 A.3d 255, 268 (Md. 2018); Cain v. Price, 415 P.3d 25, 30 (Nev. 2018); Johnson v. Little, 827 S.E.2d 207, 212 (S.C. Ct. App. 2019) (quoting Branche Builders, Inc. v. Coggins, 686 S.E.2d 200, 202 (S.C. Ct. App. 2009)).

79. Saunders v. Hudgens, 184 A.3d 345, 349 (D.C. 2018).

80. Int'l Bus. Mach. Corp. v. State *ex rel.* Ind. Family & Social Servs. Admin., 112 N.E.3d 1088, 1105 (Ind. Ct. App. 2018), *aff'd in part, vacated in part on other grounds by* 124 N.E.3d 1187 (Ind. 2019); Penzel Constr. Co. v. Jackson R-2 Sch. Dist., 544 S.W.3d 214, 235 (Mo. Ct. App. 2017); Unified Contractor, Inc. v. Albuquerque Hous. Auth., 400 P.3d 290, 302 (N.M. Ct. App. 2017) (quoting Paiz v. State Farm Fire & Cas. Co., 880 P.2d 300, 309 (N.M. 1994)); Dominion Res., Inc. v. Alstom Power, Inc., 825 S.E.2d 752, 756 (Va. 2019).

81. Rabideau v. Jessica's Corner 230, LLC, No. 3-16-0234, 2017 WL 2390947, at *6 (Ill. App. Ct. May 31, 2017); Legacy Builders, LLC v. Andrews, 335 P.3d 1063, 1068 (Wyo. 2014).

82. *See supra* note 26 and accompanying text.

83. *See* 1 WINDT, *supra* note 8, § 4:37, at 4-298 ("The insurer's breach of contract should not . . . be used as a method of obtaining coverage for the insured that the insured did not purchase.").

84. Again, a "mixed action" is case in which multiple claims are alleged against an insured but only some of which are potentially covered. Gonzalez v. Fire Ins. Exch., 184 Cal. Rptr. 3d 394, 403 (Ct. App. 2015); Fire Ins. Exch. v. Weitzel, 371 P.3d 457, 461 (Mont. 2016).

85. The Connecticut Supreme Court recognized the unfairness of this result in the analogous situation in which the insurer breaches its duty to defend and the insured later

the form of coverage for which it did not pay. As the Oregon Court of Appeals thoughtfully explained in *Northwest Pump & Equipment Co. v. American States Insurance Co.*:

> [A]n insurer's breach of the duty to defend does not give rise to a duty to indemnify unless the underlying claim is covered. That conclusion is the only one consistent with the general rule that an insured is entitled to the benefit of its bargain, and no more. The policy contains provisions specifying the conditions of coverage, exclusions and exceptions to the exclusions. To allow coverage beyond those terms—for example, to require an insurer to cover a loss that is otherwise subject to an exclusion—would be to allow the insured to obtain more than it bargained for: coverage for a noncovered claim. The foregoing conclusion also is the only one that maintains the distinction between the duty to defend, which is established by the allegations of a complaint compared with the terms of a policy, and the duty to indemnify, which is established by the actual facts demonstrating a right to recover under the policy. Finally, it is the only conclusion that is faithful to the principle that coverage may not be extended by waiver or estoppel.[86]

*Polaroid Corp. v. Travelers Indemnity Co.*[87] is another case in which a court studiously applied the majority rule. The insured, Polaroid, acknowledged that it was not "automatically entitled to indemnity" by virtue of the insurers' breach of their duty to defend.[88] Polaroid's concession was necessary; Massachusetts law was clear that "[a] failure to defend does not bar an insurer from contesting its indemnity obligation."[89] The question, rather, was whether Polaroid could recover as consequential damages for the insurers' breach of

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settles with the plaintiff. Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 67 A.3d 961, 997-99 (Conn. 2013). Thus, the *Capstone* court explained:

> For the purposes of determining the reasonableness of settlements under the equitable estoppel rule . . . we believe that the proper inquiry is whether the insurer would have had the duty to defend against each claim, contained in the complaint or fairly discernible from the demand for defense, when considered independently. To hold otherwise would be to expand coverage by estoppel to claims for which the insurer owes no duties under the policy. Because the duty to defend is broader than the duty to indemnify . . . holding a breaching insurer liable for settlement amounts attributable to claims for which there was no duty to defend is unreasonable.
>
> Accordingly, the breaching insurer's liability for reasonable costs should be limited to the portion of the settlement corresponding to claims for which the insurer had a duty to defend, when considered independently.

*Id.* at 998-99 (citation omitted).

86. 925 P.2d 1241, 1244 (Or. Ct. App. 1996).

87. 610 N.E.2d 912 (Mass. 1993).

88. *Id.* at 920-21.

89. *Id.* at 921.

the duty to defend the amounts it thereafter paid to settle the plaintiffs' claims in the underlying litigation.[90] Polaroid was not forced to settle the plaintiffs' claims as a result of its insurers' breach of the duty to defend.[91] Polaroid simply contended that "if an insurer in breach of its obligation to defend a claim declines to defend that claim, the insurer must pay the amount of any reasonable settlement that the insured makes, without regard to whether the claim was one for which coverage was provided."[92] The court disagreed.

The court focused on whether the settlements arose naturally from the insurers' breach of the duty to defend so that the amounts paid could be recoverable as contract damages.[93] In doing so, the *Polaroid* court aligned itself "with those authorities that treat an insurer's unjustified refusal to defend as a breach of contract and seek then to determine what is recoverable as contract damages."[94] The court observed that if an underlying claim, such as the plaintiffs' claims that Polaroid settled, does not fall within an insurance policy's coverage, "an insurer's improper failure to defend that claim would not ordinarily be a cause of any payment that the insured made in settlement of that claim (or to satisfy a judgment based on that claim)."[95] The *Polaroid* insurers, having proven that they had no duty to indemnify Polaroid for the underlying settlements, could not be forced to fund those settlements as consequential damages for breaching their duty to defend.[96]

Pushing back, proponents of the forfeiture-of-coverage-defenses approach argue that, in fact, an insurer's loss of its coverage defenses following a breach of the duty to defend "has an arguable grounding in the adaptation of traditional contract law" insofar as breach and damages are concerned.[97] Under settled contract law, the victim of material breach of a contract may lawfully repudiate the contract;[98] that is, a material breach of contract excuses the non-breaching party's performance.[99] "But for insurance policies," pro-forfeiture

90. *Id.*

91. *Id.*

92. *Id.* at 920.

93. *Id.* at 921.

94. *Id.*

95. *Id.* (footnote omitted).

96. *Id.* at 922-23.

97. Stempel, *supra* note 42, at 610.

98. *Id.*

99. Driveline Sys., LLC v. Arctic Cat, Inc., 936 F.3d 576, 579 (7th Cir. 2019) (discussing Illinois law); United States v. Neb. Beef, Ltd., 901 F.3d 930, 934 (8th Cir. 2018) (applying Nebraska law); C&C Road Constr., Inc. v. SAAB Site Contractors, L.P., 574 S.W.3d 576, 585 (Tex. App. 2019).

advocates argue, "this traditional approach is meaningless unless adapted to the insurance context."[100] Unlike many victims of a material breach, an insured is not realistically able to terminate the contract in response; it needs a defense in the lawsuit to which the breach relates.[101] Thus, for an insured to have an adequate remedy at its disposal when the insurer breaches its duty to defend, it is necessary to modify the material breach doctrine.[102]

"One defensible adjustment" to material breach doctrine is to hold that an insurer that materially breaches its policy by failing to defend the insured when it has a duty to do so must suffer a consequence similar to that suffered by parties that materially breach other types of contracts.[103] As noted above, parties that materially breach other types of contracts run the risk of losing the benefits of the agreement when the non-breaching party repudiates the contract.[104] Analogously, "insurers materially breaching by failing to defend should lose a major part of their initial deal with policyholders—the right to contest coverage."[105]

This creative argument serves no real purpose. Existing insurance law rooted in contract provides the insured with an adequate remedy for the insurer's breach; there is no need to conjure up an adaptation of contract law for insurance cases.

To explain, an insurer's breach of the duty to defend—a material breach of contract for sure—excuses the insured's duty to cooperate with the insurer in the defense of the case.[106] No longer bound to cooperate with the insurer, the insured may settle with the plaintiff without the insurer's permission.[107] In a typical case, the insured and the plaintiff will enter into a consent judgment (often described as a stipulated judgment) in excess of the insured's policy limits that contains an admission or confession of liability, coupled with a settlement agreement that contains a covenant to limit collection of the

100. Stempel, *supra* note 42, at 611.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. Columbus McKinnon Corp. v. Travelers Indem. Co., 367 F. Supp. 3d 123, 153 (S.D.N.Y. 2018) (quoting J.P. Morgan Sec. Inc. v. Vigilant Ins. Co., 58 N.Y.S.3d 38, 39 (App. Div. 2017)); Draggin' Y Cattle Co. v. Junkermier, Clark, Campanella, Stevens, P.C., 439 P.3d 935, 941 (Mont. 2019); JERRY & RICHMOND, *supra* note 1, at 725.

107. By declining to defend the insured, the insurer loses the ability to enforce a policy provision prohibiting settlements without its consent. The Point/Arc of N. Ky., Inc. v. Phila. Indem. Ins. Co., 154 F. Supp. 3d 503, 513 (E.D. Ky. 2015) (applying Kentucky law); Cent. Mut. Ins. Co. v. Tracy's Treasures, Inc., 19 N.E.3d 1100, 1112 (Ill. App. Ct. 2014); White Pine Ins. Co. v. Taylor, 165 A.3d 624, 642 (Md. Ct. Spec. App. 2017).

judgment to the proceeds of any insurance policies the insured holds, and an assignment of the insured's rights against its insurer to the plaintiff.[108] The consent judgment establishes the insured's liability for the loss and the insurer cannot re-litigate issues that either were or could have been litigated in the underlying action in a later declaratory judgment, equitable garnishment, or bad faith action.[109] Simply put, the insurer cannot re-litigate the insured's liability to the plaintiff.[110] The insurer is instead left to litigate with the plaintiff as the insured's assignee (1) the reasonableness of the consent judgment in terms of the amount; (2) in some cases, the plaintiff's procurement of the judgment through bad faith, fraud, or collusion; (3) the existence of coverage; and (4) the insurer's alleged bad faith liability. At the same time, the insured avoids the financial consequences of the insurer's breach by contractually limiting the plaintiff's recovery to insurance proceeds.[111]

Furthermore, an insurer that declines to defend an insured loses the right to control the defense of the lawsuit against the insured.[112]

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108. For explanations of consent judgments, see Douglas R. Richmond, *Consent Judgments and the Taint of Bad Faith, Fraud, and Collusion*, NEW APPLEMAN CURRENT CRITICAL ISSUES IN INS. LAW, Winter 2018, at 1, 1-2; Jill B. Berkeley & Seth D. Lamden, *To the Policy Limits and Beyond*, THE BRIEF, Spring 2018, at 37, 42-43; Jeffrey N. Labovitch & Cody S. Moon, *What Insurers and Their Counsel Should Know About Consent Judgments*, FOR THE DEF., May 2015, at 34, 35-37; Douglas R. Richmond, *The Consent Judgment Quandary of Insurance Law*, 48 TORT TRIAL & INS. PRAC. L.J. 537, 541-45 (2013).

109. Colo. Cas. Ins. Co. v. Safety Control Co., 288 P.3d 764, 770 (Ariz. Ct. App. 2012) (quoting State Farm Mut. Auto. Ins. Co. v. Paynter, 593 P.2d 948, 950 (Ariz. Ct. App. 1979)); Allen v. Bryers, 512 S.W.3d 17, 32-33 (Mo. 2016) (first quoting Drennen v. Wren, 416 S.W.2d 229, 234 (Mo. Ct. App. 1967); then quoting Assur. Co. of Am. v. Secura Ins. Co., 384 S.W.3d 224, 233 (Mo. Ct. App. 2012)).

110. *In re* Estate of Arroyo v. Infinity Indem. Ins. Co., 211 So. 3d 240, 246 (Fla. Dist. Ct. App. 2017).

111. *See generally Allen*, 512 S.W.3d at 32 ("Once an insurer unjustifiably refuses to defend or provide coverage, the insured may enter into an agreement with the plaintiff to limit his or her liability to the insurance policy limits."); Abbey/Land, LLC v. Glacier Constr. Partners, LLC, 433 P.3d 1230, 1241-42 (Mont. 2019) ("When an insurer fails to provide a defense, it is not per se fraudulent or collusive for its insured to sign a consent judgment and assign its rights against the insurer to a third-party claimant and to receive a covenant not to execute in return. By executing such an agreement, the insured attempts to protect itself from the exposure to personal liability to which the insurer exposed it." (citation omitted)).

112. *See* RICHMOND & JERRY, *supra* note 1, at 725 (explaining that an insurer's breach of the duty to defend is a material breach of contract that entitles the insured to assume control of its own defense); *see also* Liberty Mut. Ins. Co. v. Hamilton Ins. Co., 356 F. Supp. 3d 326, 339 (S.D.N.Y. 2018) (stating that under New York law, the insurer's breach of its duty to defend deprived it of the ability to select the insured's defense lawyer). In most states, an insurer retains the right to control the defense even where it has reserved its rights provided that the reservation of rights does not standing alone or in combination with other facts entitle the insured to independent counsel at the insurer's expense. *See, e.g.*, Graper v. Mid-Continent Cas. Co., 756 F.3d 388, 392-95 (5th Cir. 2014) (applying Texas law); Centex Homes v. St. Paul Fire & Marine Ins. Co., 228 Cal. Rptr. 3d 228, 233-35

This is an express contractual right reserved to the insurer in a standard policy.[113] The right to control the defense is extremely valuable to the insurer. Indeed, the right to control the defense allows the insurer to select and monitor defense counsel, best evaluate the plaintiff's claims, direct the defense, manage defense costs, prevent possible collusion between the insured and the plaintiff, decide whether to try or settle the case, and seize appropriate settlement opportunities.[114] An insurer that loses the right to defend may feel that loss very acutely.

In sum, the consent judgment regime provides the insured with an ample remedy for the insurer's simple breach of the duty to defend.[115] An insurer's loss of the right to control the insured's defense by way of a breach is enormously consequential for the insurer. To couch things in the language of proponents of the forfeiture-of-coverage-defenses rule, an insurer that materially breaches its contract by failing to defend does, in fact, lose major parts of its initial deal with the insured: (1) the right to insist on the insured's cooperation and compliance with key policy provisions in regard to the claim at issue; and (2) the right to control the insured's defense. Accordingly, it is unnecessary to stretch contract law with respect to material breaches in the insurance context.

### *B. The Minority Forfeiture-of-Coverage-Defenses Rule*

Although most courts to have considered the issue have concluded that an insurer that mistakenly breaches its duty to defend should retain the ability to dispute its duty to indemnify the insured, courts in a number of jurisdictions have held to the contrary.[116] Courts

(Ct. App. 2018) (discussing when an insured may be entitled to independent counsel at the insurer's expense).

113. *See, e.g.*, Ins. Servs. Office, Inc., Commercial General Liability Coverage Form (CG 00 01 04 13), at 1 (2012) (providing that the insurance company "will have the right and duty to defend the insured against any 'suit'" seeking covered damages) (on file with the author).

114. JERRY & RICHMOND, *supra* note 1, at 694.

115. *See* Charles Silver & William T. Barker, *The Treatment of Insurers' Defense-Related Responsibilities in the Principles of the Law of Liability Insurance: A Critique*, 68 RUTGERS U. L. REV. 83, 98-101 (2015) (discussing consent judgments where an insurer breaches its duty to defend an impecunious insured).

116. *See, e.g.*, *In re* Abrams & Abrams, P.A., 605 F.3d 238, 241 (4th Cir. 2010) ("Under North Carolina law, if an insurer improperly refuses to defend a claim, it is estopped from denying coverage and must pay any reasonable settlement—even if it made an honest mistake in its denial."); Columbus Life Ins. Co. v. Arch Ins. Co., No. 3:14-CV-01659, 2016 WL 2865952, at *12 (N.D. Ind. May 27, 2016) (reasoning that "Ohio courts would hold that an insurer is estopped from denying coverage where it wrongfully disclaims coverage and refuses to defend or participate in the settlement of an action brought against an insured." (footnote omitted)); Cent. Armature Works, Inc. v. Am. Motorists Ins. Co., 520 F. Supp. 283, 289-90 (D.D.C. 1980) (invoking estoppel); Lloyd's & Inst. of London Underwriting Cos.

taking the minority approach use varying language in describing the coverage-related consequences of an insurer's breach of its duty to defend, but they all effectively reason that an insurer that simply breaches its duty to defend forfeits any coverage defenses that might otherwise apply to the plaintiff's claim or suit against the insured.[117]

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v. Fulton, 2 P.3d 1199, 1209 (Alaska 2000) ("[A]n insurer's breach of the duty to defend must be considered a material breach that estops denial of coverage unless the breach clearly has no adverse impact on the relationship between the insurer and the insured."); Capstone Bldg. Corp. v. Am. Motorists Ins. Co., 67 A.3d 961, 992-99 (Conn. 2013) (holding that an insurer that breaches its duty to defend forfeits the ability to challenge claims for which it had a duty to defend, but is not obligated to pay a settlement or judgment entered on claims for which there never was the potential for coverage); Ill. Ins. Guar. Fund v. Nwidor, 105 N.E.3d 1035, 1044 (Ill. App. Ct. 2018) ("Generally, where a complaint against the insured alleges facts within or potentially within the coverage . . . and when the insurer takes the position that the policy does not cover the complaint, the insurer must (1) defend the suit under a reservation of rights or (2) seek a declaratory judgment that there is no coverage. If the insurer fails to take either of these actions, it will be estopped from later raising policy defenses to coverage."(citation omitted)); Draggin' Y Cattle Co. v. Junkermier, Clark, Campanella, Stevens, P.C., 439 P.3d 935, 941 (Mont. 2019) (explaining that "a breach of the duty to defend is a material breach of the contract . . . and equity thus estops the insurer from denying coverage and raising other contract defenses in subsequent litigation"); IMO Indus. Inc. v. Transamerica Corp., 101 A.3d 1085, 1112-13 (N.J. Super. Ct. App. Div. 2014) ("A primary insurer that refuses its obligation to defend claims against its insured without first timely challenging coverage forfeits the right to hold an insured to that burden at a later time." (citing Griggs v. Bertram, 443 A.2d 163, 171 (N.J. 1982)); Dove v. State Farm Fire & Cas. Co., 399 P.3d 400, 406 (N.M. Ct. App. 2017) (stating that "an insurer who unilaterally refuses to defend effectively waives its ability to later challenge the underlying merits as to coverage . . ."); Sanderson v. Ohio Edison Co., 635 N.E.2d 19, 24 (Ohio 1994) ("Fairness and justice demand that an insurer that breaches its duty to defend an insured be estopped from asserting, as a defense in a supplemental proceeding . . . that the insured failed to obtain the consent of the insurer to settle the action."); Conanicut Marine Servs., Inc. v. Ins. Co. of N. Am., 511 A.2d 967, 970-71 (R.I. 1986) (rejecting the insurer's argument that it should be able to dispute coverage notwithstanding its breach of the duty to defend); Summerhaze Co., L.C. v. FDIC, 332 P.3d 908, 921 (Utah 2014) ("An insurer 'that refuses a tender of defense by its insured takes the risk not only that it may eventually be forced to pay the insured's legal expenses but also that it may end up having to pay for a loss that it did not insure against." (quoting Hamlin Inc. v. Hartford Accident & Indem. Co., 86 F.3d 93, 94 (7th Cir. 1996))); Marks v. Houston Cas. Co., 881 N.W.2d 309, 332 (Wis. 2016) ("Insurers are not allowed to contest coverage *after* a court has determined that the insurer has breached the duty to defend its insured because, having breached a contractual obligation, the insurer must pay damages flowing from that breach."); *see also* Hinton v. Pekin Ins. Co., 268 So. 3d 543, 555 (Miss. 2019) (explaining that an insurer that breaches its duty to defend is estopped to deny coverage if its conduct prejudices the insured, but is not estopped if its breach does not prejudice the insured (quoting S. Farm Bureau Cas. Ins. Co. v. Logan, 119 So. 2d 268, 272 (Miss. 1960))). As noted earlier, Indiana appears to have cases adopting both the majority and minority approaches. *Compare* Grinnell Mut. Reinsurance Co. v. Ault, 918 N.E.2d 619, 625 (Ind. Ct. App. 2009) ("[A]n insurer's failure to defend an insured or seek a declaratory judgment does not waive its coverage defenses."), *with* City of Gary v. Auto-Owners Ins. Co., 116 N.E.3d 1116, 1120-21 (Ind. Ct. App. 2018) (noting that where an insurer has a duty to defend and does not either defend under a reservation of rights or file a declaratory judgment action to determine its obligations, it will be estopped from raising policy defenses to coverage.).

117. *See supra* note 116.

Initially, courts applied the forfeiture-of-coverage-defenses rule to relieve the plaintiff of "the difficult burden of proving a causal relation between the defendant's breach of the duty to defend and the results which are claimed to have flowed from it."[118] But that purpose was and is unsupportable because there is seldom a causal relationship between an insurer's breach of the duty to defend and a later settlement or judgment.[119] There are at least two reasons for this conclusion. First, any lawyer the insured hires to defend it will presumably provide the same quality of representation as the defense lawyer the insurer would have appointed had the insurer properly accepted the defense.[120] Consequently, the amount of any judgment against the insured should be the same or nearly so, regardless of who provided the defense.[121] Second, the plaintiff's case against the insured may be so strong that even a zealous defense by the insurer would not have changed the outcome.[122] Either way, the insurer's breach of its duty to defend did not cause the insured to suffer a judgment or force the insured to settle. It therefore makes no sense to broadly impose automatic liability on insurers because, in a rare case, an insurer's breach may have caused the insured's claimed damages.[123]

More recently, proponents of the forfeiture-of-coverage-defenses rule have urged its adoption or affirmation based on the concern that, if insurers can contest coverage after failing to provide a defense, they will have little incentive to defend an insured in litigation where the duty to indemnify the insured is arguable.[124] As a comment to an early draft of section 19 of the Restatement of the Law of Liability Insurance asserted:

> An insurer that could refuse to defend but still preserve its coverage defenses would be less willing to provide the promised defense. At least some such refusals go unchallenged, and, if the breaching insurer could preserve its coverage defenses, all that it would be required to pay in the event of a successful challenge is the amount that it should have paid at the time the insured needed the defense. Such reimbursement is a poor substitute for the expert litigation services

118. Missionaries of the Co. of Mary, Inc. v. Aetna Cas. & Sur. Co., 230 A.2d 21, 26 (Conn. 1967).

119. 1 WINDT, *supra* note 8, § 4:37, at 4-301.

120. JERRY & RICHMOND, *supra* note 1, at 717-18.

121. *Id.* at 718.

122. *See* Hyland v. Liberty Mut. Fire Ins. Co., 885 F.3d 482, 486-87 (7th Cir. 2018) (applying Illinois law regarding an insurer's alleged extracontractual liability for a bad faith breach of the duty to defend).

123. 1 WINDT, *supra* note 8, § 4:37, at 4-301.

124. RESTATEMENT OF THE LAW OF LIAB. INS. § 19 cmt. a (AM. LAW INST., Discussion Draft, 2015).

> provided when an insurer fulfills the duty to defend, especially for consumers and small businesses, but also for larger commercial entities that, in contrast to liability insurance companies, are not in the business of managing litigation. . . .
>
> This rule properly aligns the defense incentives of the insurer and insured in situations in which the insurer's potential coverage defense otherwise would reduce the incentive to defend the claim. In a full-coverage case, the insurer faces all of the legal risks posed by the claim and has the appropriate incentive to fulfill the duty to defend in a manner that reflects all of these legal risks. When the insurer has potential coverage defenses, however, the insurer may not face all of the legal risks posed by the claim and, therefore, does not have the same incentive to fulfill the duty to defend despite being legally obligated to do so. The [forfeiture-of-coverage-defenses rule] addresses this incentive problem. Because a breach of the duty to defend exposes the insurer to all of the legal risks posed by the claim, the insurer has the appropriate incentive to evaluate whether to defend the claim as if it faced all of those risks.[125]

Along the same lines, the forfeiture-of-coverage-defenses rule supposedly discourages an insurer from attempting to effectively convert a duty-to-defend policy into a defense-cost-indemnification policy under which the insurer reimburses the insured's defense costs or claim expenses after they are incurred.[126] In this way, the forfeiture-of-coverage-defenses rule highlights the principle that an insurer's duty to defend reflects a promise to perform rather than a promise to weigh performance against the potential cost of run-of-the-mill contract damages.[127]

As for commentators and courts who might hold the view that the forfeiture-of-coverage-defenses rule drives insurers to pay claims that are not covered and thereby unjustly enriches insureds, supporters of the rule maintain that it does no such thing.[128] So long as the insurer defends the insured under a reservation of rights, supporters point out, it preserves its coverage defenses; the insurer loses nothing.[129]

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125. *Id.* (internal citations omitted).

126. *Id.* For a discussion of defense-cost-indemnification policies, *see generally* Douglas R. Richmond, *Liability Insurance and the Duty to Pay Defense Expenses Versus the Duty to Defend*, 52 TORT TRIAL & INS. PRAC. L.J. 1 (2016).

127. RESTATEMENT OF THE LAW OF LIAB. INS. § 19 cmt. a (AM. LAW INST., Discussion Draft, 2015).

128. *Id.*

129. *See id.* (explaining how defending under a reservation of rights and, in some instances, also filing a declaratory judgment action, preserves the insurer's coverage defenses despite the forfeiture-of-coverage-defenses rule).

Indeed, an insurer's ability to preserve its coverage defenses by defending under a reservation of rights is one good reason for favoring the forfeiture-of-coverage-defenses rule.[130]

These are, in some respects, valid points. In practice, however, they lose persuasive force. To start, these rationales for the forfeiture-of-coverage-defenses rule assume a need to deter insurers from intentionally breaching their duty to defend.[131] In fact, the principal problem—if there is a problem—is insurers' *mistaken* breach of the duty to defend. An insurer that reasonably but erroneously believes that it has no duty to defend an insured and, therefore, declines to do so, is not animated by a desire to avoid its analytical or investigative responsibilities or to retroactively re-write the terms of its policy.[132] There is, in short, no misconduct to deter.

In other instances, the deterrence argument leads to results that are unfairly penal. Again, consider a case in which the plaintiff files a multi-count complaint against the insured, and the insurer mistakenly breaches its duty to defend. If it turns out that one count was potentially covered and another clearly was not, application of the forfeiture-of-coverage-defenses rule means the insurer will be forced to indemnify the insured in connection with the uncovered count. That result not only penalizes the insurer, it grants the insured a windfall.[133]

Even where an insurer's decisionmaking process arguably might benefit from a dose of deterrence, the forfeiture-of-coverage-defenses rule is unnecessary. As discussed earlier, the loss of the right to control the defense of the litigation against the insured and the threat of the insured settling without the insurer's consent or entering into a consent judgment in excess of the policy limits are powerful incentives for an insurer to err in the insured's favor when evaluating its duty to defend.[134] But, those are not the only reasons for an insurer to defend an insured in a case of doubtful coverage rather than declin-

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130. *See* JERRY & RICHMOND, *supra* note 1, at 724 (noting insurers' ability to defend pursuant to non-waiver agreements and to pursue declaratory judgment actions as procedural alternatives for insurers that also support recognition of the forfeiture-of-coverage-defenses rule).

131. *See* Foggan & Toto, *supra* note 40, at 73 (discussing the theoretical concern that an insurer "might convert its policy from one providing a defense into one simply reimbursing defense costs unless threatened with the penalty of losing its indemnity defenses" (footnote omitted)).

132. *Id.*

133. This result is avoidable if the court requires the total award to be allocated between covered and uncovered claims. *See* RSUI Indem. Co. v. New Horizon Kids Quest, Inc., 933 F.3d 960, 963-64 (8th Cir. 2019) (applying Minnesota law and discussing allocation).

134. *See supra* notes 106-14 and accompanying text.

ing a defense. For example, if the insured does not hire its own defense counsel following the insurer's breach and therefore suffers a default, the insurer may have to satisfy the default judgment.[135] If the insured does defend itself, it may structure the defense so that any liability rests on grounds that the policy covers.[136] In any event, the insurer may be exposed to extracontractual liability for failing to settle the case within policy limits if it turns out there was coverage under the policy because, having failed to defend, it will not learn of any settlement offers that the plaintiff makes to the insured.[137]

These potential consequences of a breach significantly discourage insurers from cavalierly evaluating their duty to defend, as do the legal costs of any breach of contract, bad faith, declaratory judgment, or equitable garnishment litigation arising out of the insurer's alleged breach of its duty to defend.[138] Indeed, insurers defend many more lawsuits against their insureds than might otherwise be expected simply to avoid the risk of extracontractual liability and tangential litigation in the event of a misjudgment.[139] In the rare case in which an insurer knowingly declines to defend an insured despite recognizing its duty to do so or in reckless disregard of its duty to do so, it is potentially guilty of bad faith and consequently exposed to punitive damages.[140]

As the Hawaii Supreme Court summarized in rejecting the forfeiture-of-coverage-defenses rule in *Sentinel Insurance Co., Ltd. v. First Insurance Co. of Hawai'i, Ltd.*:[141]

> [A]ny justification for the rule based on the conception that the insurer gains an unfair advantage by its breach of contract is tenuous. To the contrary, the insurer that refuses to defend does so at its own peril. For example, the insurer forfeits any right to control the defense costs and strategy, including the right to compel the insured's cooperation in the defense of the claims; if it loses its claim of no duty to defend, it will be obliged to reimburse the insured for all reasonable defense fees and costs properly incurred. Additionally, the breaching insurer waives its right to approve of any settlement. . . . [T]he insured is entitled to negotiate a reasonable and good faith settlement of the underlying claim which amount may then be utilized as presumptive

135. 1 WINDT, *supra* note 8, § 4:38, at 4-303.

136. *Id.* § 4:38, at 4-303 to -304.

137. *Id.* § 4:38, at 4-304.

138. 1 WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION SECOND EDITION § 1.05[6][c], at 1-32.15 (2010 & Supp. 2018).

139. *See* JERRY & RICHMOND, *supra* note 1, at 722 (referring to the risk of extracontractual liability).

140. RESTATEMENT OF THE LAW OF LIAB. INS. §§ 49, 50(3) (AM. LAW INST. 2019).

141. 875 P.2d 894 (Haw. 1994).

> evidence of the breaching insurer's liability. Thus, by refusing to provide a defense, the insurer risks liability for a settlement in an amount that, although reasonable, could be higher than it might have been able to secure. The same type of danger is inherent in a verdict rendered at trial.[142]

With respect to insurers' shelter against forfeiture under the reservations of rights doctrine, it is certainly true that, in most cases, an insurer that defends under a reservation of rights preserves its right to contest coverage and avoids the harsh effects of the forfeiture-of-coverage-defenses rule. But, this is not uniformly true. In some jurisdictions, insureds may reject a defense under reservation of rights.[143] In these jurisdictions the insured has the option of accepting the defense under reservation of rights if it wishes, but the insurance company cannot compel it to do so.[144]

If the insured rejects a defense under reservation, the insurer has limited options unless it can negotiate some mutually agreeable arrangement with the insured. First, the insurer can withdraw its reservation of rights and proceed to defend the insured as though coverage was never in question.[145] In that case, the insured may well receive coverage to which it is not entitled and for which it never paid.

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142. *Id.* at 913 (citations omitted).

143. *See, e.g.*, Mid-Continent Cas. Co. v. Am. Pride Bldg. Co., 601 F.3d 1143, 1149 (11th Cir. 2010) (discussing Florida law); United Nat'l Ins. Co. v. SST Fitness Corp., 309 F.3d 914, 921 (6th Cir. 2002) (applying Ohio law); Rhodes v. Chi. Ins. Co., 719 F.2d 116, 120 (5th Cir. 1983) (applying Texas law); Sauer v. Home Indem. Co., 841 P.2d 176, 182-83 (Alaska 1992) ("Under . . . a reservation of rights letter the insurance company can preserve its option to later disclaim coverage after conducting the defense. However, if the insured does not consent . . . to a defense under a reservation of rights, then the insurance company must choose whether it wishes to defend unconditionally or pursue other options." (citation omitted)); Finley v. Home Ins. Co., 975 P.2d 1145, 1155 (Haw. 1998) ("Although we acknowledge the contractual right of an insurer to select counsel for the insured in the tender of a defense under a reservation of rights, it is well settled that the insured must have the right to reject this tender."); Med. Protective Co. v. Davis, 581 S.W.2d 25, 26 (Ky. Ct. App. 1979) ("We elect to align ourselves with those jurisdictions which hold that an insured is not required to accept a defense offered by the insurer under a reservation of rights."); Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co., 788 N.E.2d 522, 539 (Mass. 2003) ("When an insurer seeks to defend its insured under a reservation of rights, and the insured is unwilling that the insurer do so, the insured may require the insurer either to relinquish its reservation of rights or relinquish its defense of the insured and reimburse the insured for its defense costs."); Allen v. Bryers, 512 S.W.3d 17, 32 (Mo. 2016) ("It is well-settled that an insured has the right to reject a reservation of rights defense."); Nat'l Mortg. Corp. v. Am. Title Ins. Co., 255 S.E.2d 622, 629-30 (N.C. Ct. App. 1979) ("Just as an insured is not required to accept a defense conditioned upon entering into a 'non-waiver agreement', he is not required to accept a defense rendered under a 'reservation of rights."), *rev'd on other grounds*, 261 S.E.2d 844 (N.C. 1980).

144. *Allen*, 512 S.W.3d at 32 (quoting Ballmer v. Ballmer, 923 S.W.2d 365, 369 (Mo. Ct. App. 1996)).

145. *Id.* (quoting Kinnaman-Carson v. Westport Ins. Corp., 283 S.W.3d 761, 765 (Mo. 2009)).

Second, the insurer can refuse to withdraw its reservation of rights and stand on its coverage defenses.[146] That approach is often unsatisfactory, however, because it exposes the insurer to breach of contract and bad faith allegations, and, in any event, may leave the insurer bound by the facts as determined in the third-party action.[147] Third, the insurer may file a declaratory judgment action to obtain a judicial determination of its obligations. Depending on the jurisdiction, however, pursuing a declaratory judgment action can be perilous.[148] In Missouri, for example, the insurer's pursuit of a declaratory judgment is treated as a refusal to defend the insured, and, if the insurer loses, it is treated as if it had waived the right to control the defense of the underlying litigation.[149] In addition, in all jurisdictions the insured will probably counterclaim in the declaratory judgment action for breach of contract and bad faith.[150]

In summary, in any jurisdiction in which an insured can reject a defense under reservation of rights, an insurer cannot necessarily avoid the severe consequences of the forfeiture-of-coverage-defenses rule. To the contrary, an insurer in many cases find itself unfairly thrust on the horns of a dilemma: (1) accept the duty to indemnify the insured for an uncovered claim; or (2) risk all the consequences of a breach of the duty to defend.

Finally, consider that some insurance companies sell liability policies that cover defense costs but do not include a duty to indemnify the insured in the event it is found liable in connection with a covered proceeding.[151] Assuming that an insurer that breaches its duty to pay defense costs under such a policy will only be liable for conse-

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146. *See id.* (quoting *Kinnaman-Carson*, 283 S.W.3d at 765).

147. *See* Metro. Prop. & Cas. Ins. Co. v. Morrison, 951 N.E.2d 662, 668-70 (Mass. 2011) (discussing the insurer's breach of contract and effect of default by defendant in the underlying action).

148. In theory, an insurer can mitigate some of its risk by asking the court hearing the third-party action to stay that case pending the outcome of the declaratory judgment action. Ballmer v. Ballmer, 923 S.W.2d 365, 369-70 (Mo. Ct. App. 1996). But courts are seldom willing to grant stays because they do not want to delay or impede an injured plaintiff's potential recovery. In balancing the plaintiff's interests against the insurer's interests, they simply favor the third-party plaintiff. Augspurger v. MFA Oil Co., 940 S.W.2d 934, 936 (Mo. Ct. App. 1997) (citing Lodigensky v. Am. States Preferred Ins. Co., 898 S.W.2d 661, 667 (Mo. Ct. App. 1995)).

149. *Allen*, 512 S.W.3d at 32 (quoting *Ballmer*, 923 S.W.3d at 369).

150. *See* Safeco Ins. Co. of Am. v. Sims, 435 So. 2d 1219, 1222 (Ala. 1983) (concluding that the insured's bad faith claim was a compulsory counterclaim that had to be asserted in the insurance company's declaratory judgment action).

151. Silver & Barker, *supra* note 115, at 101 (referring to a medical liability insurance company that "sells defense cost coverage for administrative proceedings and governmental investigations, but does not indemnify physicians for losses resulting from these proceedings").

quential damages, why should "a different and more advantageous remedy be available" when the insurer similarly errs in a case in which its policy provides both a duty to defend and a duty to indemnify the insured?[152] The existence of a duty to indemnify does not aggravate the insurer's breach of its duty to defend or enhance its seriousness.[153] And if traditional contract remedies will make the insured whole when an insurer materially breaches a policy that solely covers defense costs, it follows that the additional remedy of automatic indemnity under the forfeiture-of-coverage-defenses rule is excessive.[154]

### *C. The Forfeiture-of-Coverage-Defenses Rule in the Bad Faith Context*

Washington courts, which generally adhere to the majority approach and allow an insurer to dispute coverage following a simple breach of the duty to defend, apply the forfeiture-of-coverage-defenses rule where an insurer breaches its duty to defend in bad faith.[155] Although the law in other states is unclear on this issue or altogether lacking, it is reasonable to think that other courts might adopt this approach on the right facts.[156] The Restatement endorses the loss of coverage defenses as a remedy for an insurer's bad faith breach of its duty to defend.[157]

The forfeiture-of-coverage-defenses rule is thought to be particularly appropriate where an insurer refuses to defend in bad faith because it reinforces the importance of the duty to defend, which is an

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152. *Id.*

153. *Id.*

154. *Id.* at 101-02.

155. *See, e.g.*, Truck Ins. Exch. v. Vanport Homes, Inc., 58 P.3d 276, 281 (Wash. 2002) ("[W]e hold that an insurer that refuses or fails to defend in bad faith is estopped from denying coverage."); United Servs. Auto. Ass'n v. Speed, 317 P.3d 532, 542 (Wash. Ct. App. 2014) ("Estoppel to deny coverage is one remedy for breaching a duty to defend in bad faith. But in the absence of bad faith, coverage by estoppel does not apply."). *Cf.* Amato v. Mercury Cas. Co., 61 Cal. Rptr. 2d 909, 914 (Ct. App. 1997) (reasoning that where the insurer tortiously breaches its duty to defend and the insured suffers a default judgment because of the breach, "the insurer is liable on the judgment and cannot rely on hindsight that a subsequent lawsuit establishes noncoverage").

156. *See* Parsons v. Cont'l Nat'l Am. Grp., 550 P.2d 94, 99 (Ariz. 1976) ("When an attorney who is an insurance company's agent uses the confidential relationship between an attorney and a client to gather information so as to deny the insured coverage under the policy . . . we hold that such conduct constitutes a waiver of any policy defense, and is so contrary to public policy that the insurance company is estopped as a matter of law from disclaiming liability under an exclusionary clause in the policy."); James v. Paul, 49 S.W.3d 678, 689 (Mo. 2001) ("Estoppel, being an equitable doctrine, applies where the refusal to defend was unjustified under the circumstances. State Farm justifiably relied on the prior judicial admission and determination in concluding it had no coverage and, thus, no duty to defend Paul.").

157. RESTATEMENT OF THE LAW OF LIAB. INS. § 50(2) & cmt. c (AM. LAW INST. 2019).

essential aspect of the liability insurance bargain.[158] An insurer that could abandon its insured whenever it viewed the facts bearing on coverage as slanted heavily in its favor, free from the concern of having to indemnify the insured or fund a settlement within policy limits, supposedly would have an incentive to do so.[159] In this way the forfeiture-of-coverage-defenses rule is in harmony with the remedy of extracontractual liability for an insurer's bad faith failure to settle a claim or suit against the insured within policy limits,[160] which addresses the potential misalignment of interests between the insurer and the insured in the settlement context.[161] Both remedies supposedly align the insurer's incentives with the insured's interests by compelling the insurer to consider the insured's full potential loss when making a critical decision.[162]

Under the Restatement, an insurer breaches its duty to defend in bad faith if it declines to defend (a) without a reasonable basis for its refusal to do so; and (b) with knowledge that it owes a duty to defend or in reckless disregard of whether it has a duty to defend.[163] Alternatively, as a Washington court explained: "An insurer acts in bad faith if its breach of the duty to defend was unreasonable, frivolous, or unfounded."[164] An insurer does not act in bad faith, however, when it declines to defend an insured based on a reasonable interpretation of the insurance policy in question.[165] Where an insured's entitlement to coverage is fairly debatable, an insurer may contest its duty to defend without committing bad faith.[166] Taking matters one step further, an insurer certainly cannot be guilty of bad faith where it correctly denies a duty to defend.[167]

It is difficult to feel sympathy for an insurer that refuses to defend an insured in bad faith, but there are numerous disincentives for an

158. *Id.* § 50 cmt. c.

159. *Id.*

160. For a discussion of insurers' settlement obligations and their potential liability for failing to settle a claim or suit against an insured within policy limits, see JERRY & RICHMOND, *supra* note 1, at 730-44.

161. RESTATEMENT OF THE LAW OF LIAB. INS. § 50 cmt. c (AM. LAW INST. 2019).

162. *Id.*

163. *Id.* § 49.

164. Robbins v. Mason Cty. Title Ins. Co., 425 P.3d 885, 893 (Wash. Ct. App. 2018).

165. *Id.*

166. Phila. Indem. Ins. Co. v. Youth Alive, Inc., 732 F.3d 645, 650 (6th Cir. 2013) (applying Kentucky law); Ind. Ins. Co. v. Kopetsky, 11 N.E.3d 508, 529-31 (Ind. Ct. App. 2014); *see also In re* Mt. Hawley Ins. Co., 829 S.E.2d 707, 714 (S.C. 2019) ("Of course, however, '[i]f there is a reasonable ground for contesting a claim, there is no bad faith." (quoting Crossley v. State Farm Mut. Auto. Ins. Co., 415 S.E.2d 393, 397 (1992)).

167. United Servs. Auto. Ass'n v. Speed, 317 P.3d 532, 542 (Wash. Ct. App. 2014).

insurer to willingly or recklessly breach its duty to defend,[168] possibly including liability for punitive damages.[169] The forfeiture-of-coverage-defenses rule adds nothing.

As for promoting the forfeiture-of-coverage-defenses rule by analogizing the rule to an insurer's duty to make reasonable settlement decisions, that comparison is imperfect. An insurer that must satisfy an excess judgment against its insured because it unreasonably failed to settle the lawsuit against the insured within policy limits is being made to pay compensatory damages for its miscalculation.[170] After all, had the insurer settled the lawsuit when it had the opportunity to do so, there would have been no excess judgment.[171] But before the insurer can be held liable for the excess judgment, it must owe a duty to indemnify the insured for the judgment up to the policy limits; in other words, there must be coverage for the loss.[172] An insurer generally has no duty to settle in the absence of coverage.[173] In some jurisdictions, an insurer has no duty to settle where it has a reasonable basis in fact or law for disputing coverage.[174]

In comparison, the forfeiture-of-coverage-defenses rule obligates the insurer to indemnify the insured for uncovered claims. There is nothing compensatory about such damages. Unlike extracontractual liability for failing to settle, the insurer's forfeiture of its coverage defenses does not restore the insured the position it would have occupied had the insurer performed its duty as required. In fact, the forfeiture-of-coverage-defenses rule may improve the insured's position. And, if the claims or causes of action against the insured are ultimately held to be covered, the forfeiture-of-coverage-defenses rule has again served no purpose.

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168. *See supra* notes 106-14 and 134-37 and accompanying text.

169. RESTATEMENT OF THE LAW OF LIAB. INS. § 50(3) (AM. LAW INST. 2019).

170. 1 BARKER & KENT, *supra* note 138, § 1.05[6][c], at 1-32.13.

171. *Id.*

172. Houston Cas. Co. v. Strata Corp., 915 F.3d 549, 552 (8th Cir. 2019) (applying North Dakota law); DeWitt v. Monterey Ins. Co., 138 Cal. Rptr. 3d 705, 719 (Ct. App. 2012) (quoting Marie Y. v. Gen. Star Indem. Co., 2 Cal. Rptr. 3d 135, 157 (Ct. App. 2003)); Seger v. Yorkshire Ins. Co., Ltd., 503 S.W.3d 388, 395-96 (Tex. 2016).

173. *See, e.g.*, Twin City Fire Ins. Co. v. Colonial Life & Accident Ins. Co., 375 F.3d 1097, 1102-04 (11th Cir. 2004) (applying South Carolina law); Am. Family Mut. Ins. Co. v. Westfield Ins. Co., 962 N.E.2d 993, 1000 (Ill. App. Ct. 2011) ("An insurer has a duty to act in good faith in responding to settlement offers, for example where the third party has offered to settle for an amount less than the policy limits, but that duty only exists where there is coverage under the policy."); Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co., 77 S.W.3d 253, 261 (Tex. 2002) ("Under the common law, an insurer generally has no obligation to settle a third-party claim against its insured unless the claim is covered under the policy.").

174. Catlin Specialty Ins. Co. v. QA3 Fin. Corp., 629 F. App'x 127, 131 (2d Cir. 2015) (applying New York law); State Farm Mut. Auto. Ins. Co. v. Freyer, 312 P.3d 403, 418 (Mont. 2013).

## IV. CONCLUSION

The preparation of the Restatement of the Law of Liability Insurance brought into sharp focus the possible consequences from a coverage standpoint of an insurer's breach of its duty to defend. Ultimately, the Restatement reached the right result in deciding that an insurer that mistakenly breaches its duty to defend should retain the ability to contest coverage.[175] This is the majority rule and for good reason. Preserving the insurer's ability to contest coverage following a mistaken breach of the duty to defend recognizes that insurance policies are contracts and that an insurer's simple breach of its duty to defend is but a breach of contract. Damages for breach of contract are intended to restore the injured party to the position it would have enjoyed had the breaching party instead performed its obligations—or to at least come close. The injured party is not entitled to be placed in a better position than it would have occupied had there been no breach. The forfeiture-of-coverage-defenses rule, however, grants the insured a windfall in the form of coverage that it was not owed. The forfeiture-of-coverage-defenses rule is therefore inconsistent with entrenched contract law. Furthermore, should an insurer mistakenly breach its duty to defend, an insured has multiple adequate remedies available to it as a matter of contract law; there is no need to punitively strip an insurer of its coverage defenses.

The forfeiture-of-coverage-defenses rule, though perhaps superficially appealing, is flawed in several respects. Most fundamentally, the forfeiture-of-coverage-defenses rule assumes a need to deter insurers from recklessly or intentionally breaching their duty to defend. Yet, an insurer that reasonably but erroneously declines to defend an insured is not fueled by any improper purpose or even by carelessness or recklessness. There is nothing to deter in that case. Even where deterrence might be called for, numerous consequences of an insurer's breach of the duty to defend already suffice, including the loss of the right to control the defense of the litigation against the insured; the threat of the insured settling without the insurer's consent or entering into a consent judgment in excess of the policy limits; the insurer's potential liability for a default judgment if the insured does not hire its own defense counsel following the insurer's breach; and exposure to extracontractual liability for failing to settle the case within policy limits if it turns out there was coverage under the policy because, having failed to defend, it will miss out on any settlement opportunities. At base, the forfeiture-of-coverage-defenses rule has no obvious material benefits.

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175. *See* RESTATEMENT OF THE LAW OF LIAB. INS. § 19 (AM. LAW INST. 2019) ("Consequences of Breach of the Duty to Defend").

Finally, the middle ground approach, which imposes the forfeiture-of-coverage-defenses rule only where an insurer breaches its duty to defend in bad faith, while again superficially appealing, generally serves no practical purpose. The Restatement's subtle endorsement of this approach is not compelling.