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Insurance Company Can't Take Discovery Potentially Harmful To Its Policyholder's Defense

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In its effort to avoid coverage, an insurance company may want to dig into facts that might undermine its policyholder's defense of an underlying lawsuit. That strategy recently met a strong rebuke from the Supreme Court of Washington, and policyholders can cite this decision whenever their insurers seek discovery that could be prejudicial in the underlying case.

In *Expedia, Inc. v. Steadfast Ins. Co.,* Expedia sought coverage for dozens of lawsuits filed by local taxing authorities alleging that Expedia failed to collect the right amount of local occupancy taxes from hotel customers. Zurich refused to defend, on various grounds including that Expedia's actions were potentially willfully dishonest. Expedia sued for coverage and took discovery from Zurich regarding the meaning of key policy terms, and the trial court denied Zurich's motion for summary judgment. Expedia then filed its own motion for summary judgment regarding the duty to defend. Zurich requested discovery and a continuance of the summary judgment motion.

Despite recognizing that Zurich's discovery regarding Expedia's knowledge or intent regarding its tax collection practices could harm Expedia's interests in the underlying lawsuits, the trial court ordered the discovery to proceed before it would address the duty to defend. The Washington Supreme Court unanimously reversed and remanded to the trial court to determine Zurich's duty to defend and stay any discovery that is potentially prejudicial to Expedia in the underlying litigation.

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Duty to Defend

Two important principles supported the Court's decision. First, the duty to defend is generally determined by the eight corners of insurance policy and the underlying complaint, and extrinsic evidence can be used only to trigger the duty to defend rather than deny it. Second, "[i]t is a cornerstone of insurance law that an insurer may never put its own interests ahead of its insured's."

The strategy that Zurich attempted against Expedia is all too familiar. Even in response to a non-adversarial tender letter, our clients often hear an insurance company say it can't determine if it has a duty to defend until the insured provides lots of information about the facts alleged by the plaintiff. Sometimes the insurer even threatens that failing to provide that information would breach the policyholder's duty to cooperate and eliminate coverage. Wrong. The insurance company cannot demand or use extrinsic evidence to deny its duty to defend.

While the insurer may eventually be entitled to detailed factual information relevant to whether it ultimately must indemnify a settlement or judgment against the insured, that information generally is neither necessary nor relevant to the much broader duty to defend. Moreover, if the insurer demands similar information in discovery in coverage litigation – that is, in a public forum – that discovery must be stayed if it might harm the policyholder's defense of the underlying lawsuit against it. The insurer may never put its own interests ahead of its insured's.