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## **Nevada Supreme Court Leaves Coal in Insurers' Holiday Stockings**

By Andrew B. Downs

Late last week, the Nevada Supreme Court issued a far reaching opinion on liability insurers' duty to defend. The court held an insurer who breaches the duty to defend can be held liable for the entirety of an excess judgment in excess of policy limits, even if the insurer acted in good faith when it denied the defense. It also concluded, following the new Restatement of Liability Insurance, that insurers may not rely upon extrinsic evidence to deny a defense, although if they agree to defend they may then rely on extrinsic evidence in coverage litigation to show there was no duty to defend.

Century Surety Co. v. Dana Andrew, 134 Nev.Adv.Op 100 (December 12, 2018) resulted from a default judgment for \$18,050,000 in a motor vehicle accident case. The policy was a commercial motor vehicle policy. The coverage issue was whether the at-fault driver was acting in the course and scope of his employment at the time of the accident. The insurer determined the driver was not driving in the course and scope of employment so it denied coverage and refused to defend. The policyholder failed to defend itself and a default judgment was entered. Following a post-judgment assignment by the policyholder, the claimant filed suit against the insurer. The federal district court found the insurer had not breached the implied covenant of good faith and fair dealing, but it did owe a duty to defend. It then certified to the Nevada Supreme Court the question of whether the insurer's liability for failing to defend was capped at the policy limits. The Nevada Supreme Court concluded the insurer's liability was not capped so that it could be liable for the full amount of the stipulated judgment as consequential damages stemming from the breach of the duty to defend.

In concluding the insurer's liability was not capped, the Nevada Supreme Court adopted the expectancy theory of contractual damages embodied in section 347 of the Restatement (2d) of Contracts, under which recoverable damages for breach of contract extend not only to the value of the contractual performance not received, but also "any other loss, including incidental or consequential loss, caused by the breach." In reaching this conclusion, the court recognized it was adopting the minority view (most states cap liability in the absence of bad faith at policy limits), the court also referred to the final pre-adoption draft of the Restatement of Liability Insurance.

The Nevada court did not create a complete strict liability regime, however. It held the policyholder (or claimant in the policyholder's shoes) must prove the breach caused the entry of the excess judgment and also that the policyholder continued to have a duty to protect itself and mitigate its damages.

The Nevada Supreme Court's second disturbing conclusion comes in footnote 4 where it discussed the standard for determining whether a duty to defend exists. In doing so, it addressed an issue not placed before it by the certification order, stating "We take this opportunity to clarify that where there is potential for coverage based on 'comparing the allegations of the complaint with the terms of the policy' an insurer does have a duty to defend." Again relying on the new Restatement of Liability Insurance, the court concluded insurers may not use facts outside those in the complaint as a basis for refusing to defend, but if the insurer defends it may rely on those same facts in a subsequent declaratory judgment or coverage action to argue there is no coverage and no duty to defend.

Century Surety is significant to Nevada practice. Traditionally, Nevada has largely followed California law (which follows the majority rule and allows the use of extrinsic evidence to avoid a duty to defend). By adopting a strict "four corners" standard for determining whether a



defense is owed, the court has tilted the balance in favor of policyholders to a significant degree. By allowing recovery of the entire judgment without proving the insurer acted in bad faith, it has radically raised the stakes for an insurer who opts to deny a defense.