

Reasonable Dispute Over Interpretation of Policy Precludes Bad Faith

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The United States District Court for the Southern District of Ohio has held that an insurer did not act in bad faith by refusing to pay defense costs or indemnify the insured because the insurer reasonably believed that the policyholder breached the insurance policy and relieved the insurer of its coverage obligations.

Abercrombie & Fitch Co. v. Fed. Ins. Co., 2011 WL 1237611 (S.D. Ohio Mar. 30, 2011). The court also held that, upon its determination that the insured had not breached the policy and the insurer's payment of policy limits, the insured's request for declaratory judgment that coverage was available under the policy should be dismissed but that the insured's breach of contract counts remained viable to determine whether the insurer owed pre-judgment interest.

The insurer denied coverage because it believed that the insured, a clothing company, had breached the terms of the insurance policy, which the insurer contended relieved it of any obligations under the policy. The district court held that the clothing company had not breached the terms of the policy. A divided panel of the United States Court of Appeals for the Sixth Circuit later affirmed the district court's opinion. After the appeal, the insurer paid the full limits of liability and moved for summary judgment on the policyholder's counts for bad faith, declaratory judgment, and breach of contract.

The court held that the insurer did not commit bad faith by initially denying coverage or by continuing to deny coverage during the pendency of litigation. The court reasoned that a reasonable person could have interpreted the policy in the same manner as the insurer, as recognized by a dissenting opinion in the appellate court that the insured had breached the terms of the policy. The court also held that the insurer's continued reliance on a reasonable interpretation of the policy during the pendency of the litigation did not constitute bad faith.

Because the insurer paid the policy limits, the court held that the insured's request for a declaration of its rights under the policy did not present an actual controversy. The court, however, refused to dismiss the clothing company's breach of contract claim because the court concluded that its claim for pre-judgment interest remained viable.