Journal of Consumer Attorneys Associations for Southern California
ADVOCATE
June 2012 Issue

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The breadth of an insurer's duty to defend

"California courts have repeatedly found that remote facts buried within causes of action … are sufficient to invoke the defense duty."

Liability insurance policies typically impose two key duties upon an insurer – the duty to defend and the duty to indemnify. These duties usually are found in the "coverage grant" of a policy. The standard form Commercial General Liability policy coverage grant states:

> We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" [or "personal and advertising injury"] to which this insurance applies. We will have the right and duty to defend the insurer against any "suit" seeking those damages.

(*Commercial General Liability Coverage Form, §§ I.1.a & I.B.1.a* (*ISO Properties, Inc. 2006*).)

In the landmark decision of *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, the California Supreme Court recognized that a policy "provides for an obligation to defend and that such obligation is independent of the indemnification coverage." (*Id*. at 274.) The court then addressed the broad scope of the duty to defend. It held that an insurer must defend a suit that "potentially seeks damages within the coverage of the policy . . . ," and that the insurer "bears a duty to defend its insured whenever it ascertains facts which give rise to the potential of liability under the policy." (*Id*. at 275-77.) As the court subsequently explained, the duty arises when the insurer "is informed of [an] accident and learns of even the potential for liability under its policy." (*Samson v. Transamerica Ins. Co*. (1981) 30 Cal.3d 220, 239.)

> California courts routinely have recognized the importance of the duty to defend: The defense duty is a continuing one, arising on tender of defense and lasting until the underlying lawsuit is concluded or until it has been shown that there is no potential for coverage . . . . Imposition of an immediate duty to defend is necessary to afford the insured what it is entitled to: the full protection of a defense on its behalf.

(*Montrose Chem. Corp. v. Superior Court* (1993) 6 Cal.4th 287, 295 (citation omitted).)

Therefore, "Any doubt as to whether the facts establish the existence of the defense duty must be resolved in the insured's favor." (*Id*. at 299-300.) An insurer's duty to defend is triggered by allegations in a complaint or by facts extrinsic to the complaint that "reveal a possibility that the claim may be covered by the policy." (*Horace Mann Ins. Co. v. Barbara B*. (1993) 4 Cal.4th 1076, 1081.) The duty arises even when a complaint alleges covered and non-covered acts, and even when the uncovered claim "is the 'dominant factor' in [the] case." As the *Horace Mann* court explained, the question is not whether non-covered acts predominate, but "whether there is any potential for liability under the policy." (Ibid.) Nothing "beyond a bare 'potential' or 'possibility' of coverage [is required'] as the trigger of a defense duty." (*Montrose*, 6 Cal.4th at 300.)

Courts construe the allegations in the underlying complaints liberally so that the duty does not depend on inartful drafting by the underlying claimant. As the *Gray* court explained:

> [The insurer] cannot construct a formal fortress of the third party's pleadings and retreat behind its walls. The pleadings are malleable, changeable and amendable . . . . [C]ourts do not examine only the pleaded word but the potential liability created by the suit.

(*Id*., 65 Cal.2d at 276.)

Indeed, "California courts have repeatedly found that remote facts buried within causes of action that may potentially give rise to coverage are sufficient to invoke the defense duty." (*Pension Trust Fund for Operating Eng'rs v. Fed. Ins. Co*. (9th Cir. 2002) 307 F.3d 944, 951 (citation omitted).)

Similarly, coverage is not governed by any label attached to allegations. (See *CNA Cas. v. Seaboard Sur. Co*. (1986) 176 Cal.App.3d 598, 609 ["it is not the form or title of a cause of action that determines the carrier's duty to defend, but the potential liability suggested by the facts alleged or otherwise available to the insurer"].) As the Ninth Circuit has explained:

> The *CNA* [Casualty] court cited approvingly to *Ruder & Finn v. Seaboard Sur*. (1981) 52 N.Y.2d 663 [439 N.Y.S.2d 858], wherein a New York court determined that an insurance company had a duty to defend its insured against an antitrust action that included an allegation of "false disparagement." See *CNA*, 176 Cal.App.3d at 611-12. The court rejected the insurer's argument that "two solitary, unsubstantiated words" buried within "completely unrelated federal antitrust cause of action, which was, itself, undisputedly not covered" could not trigger the duty to defend.

(*Pension Trust*, 307 F.3d at 951 n.4 (citation omitted).)

Two little words

Another Ninth Circuit decision provides an example of how the duty to defend is triggered based on a similar notion of "two solitary, unsubstantiated words" buried in a complaint. In *Manzarek v. St. Paul Fire & Insurance Co*. (9th Cir. 2008) 519 F.3d 1025, 1031, Robby Krieger and Ray Manzarek, two of the founding members of The Doors, had been sued by John Densmore, the drummer of The Doors. Densmore alleged that Krieger and Manzarek, who were touring as members of the band "The Doors of the 21st Century," and their touring company, Doors Touring,

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Inc., were liable for infringing on The Doors name, trademark, and logo in conjunction with tours and marketing. Densmore also alleged, in a single paragraph in his 68-paragraph complaint, that he had suffered damage to his "reputation and stature" because the infringement caused people to believe "that he was not, and is not, an integral and respected part of The Doors band or is one member who can easily be replaced by another drummer.

Manzarek and Doors Touring notified their insurer, seeking coverage for "advertising injury" (which included libel, slander, and disparagement) and "bodily injury" (which included mental anguish and emotional distress). The insurer denied coverage. It first contended that there was no coverage for the copyright infringement and related claims because the policy had an exclusion for claims arising in the "field of entertainment," which applied to the publication and advertising of products and materials in media. The insurer next claimed that Densmore had not alleged "bodily injury."

The Ninth Circuit Court of Appeals disagreed. It began by analyzing the duty to defend. It emphasized that, "Any doubt as to whether the facts establish the existence of the defense duty must be resolved in the insured's favor." (*Id*. at 1032.) The court held that the field of entertainment exclusion did not apply. It pointed out that the exclusion would not apply, for example, if Manzarek and Doors Touring "began distributing 'The Door's Own' line of salad dressing . . . because [they] would not necessarily publicize, distribute, exploit, exhibit, or advertise in media such as motion pictures." (*Id*. at 1032-33.) It further noted that the exclusion also would not bar all coverage if they "began marketing a line of t-shirts or electric guitars with The Doors logo or [Jim] Morrison's likeness on them." (*Id*. at 1033.) It then held that the insurer had a duty to defend because the underlying complaint was "silent about what type of products and merchandise that Manzarek and [Doors Touring] produced and marketed." (*Ibid*.) This sufficed to trigger the defense duty.

The Ninth Circuit next turned to the question of whether the policy's "bodily injury" coverage obligated the insurer to defend. It rejected the insurer's argument that there was no potential for "bodily injury" coverage. It held that the allegations that Densmore's "reputation and stature" had been damaged were "sufficient to raise the potential of an award of mental anguish or emotional distress damages," even though the complaint contained no emotional distress cause of action and did not refer to emotional distress.

These decisions establish the importance of considering not only the causes of action alleged in a complaint, but also every word in the complaint and facts and evidence outside of the complaint. Furthermore, it is important to consider all of the words in an insurance policy because a policy may provide coverage for a wide range of claims, such as bodily injury, emotional distress (sometimes included within "bodily injury" or "personal injury"), damage to property and loss of use of tangible property (typically included within "property damage), and libel, slander, disparagement, invasion of privacy, "wrongful entry or eviction: (all usually included within "personal and advertising injury"), and even discrimination, piracy, and unfair competition (found in some policies including older definitions of "personal injury'). When all of these possibilities are considered, an insurer often has a duty to defend.

Personal and advertising injury

In fact, California courts and courts around the country employing the same "potential for coverage" standard have found that insurers have a duty to defend in a wide range of contexts where coverage might not seem evident. The following are some examples of claims as to which courts have held that an insurer has a duty to defend under "personal and advertising injury" provisions:

• Antitrust and unfair trade practices in conspiracy. *Tews Funeral Home, Inc. v. Ohio Cas. Ins. Co*. (7th Cir. 1987) 832 F.2d 1037, 1045 (funeral services and products); *St. Paul Fire & Marine Insurance Co. v. Medical X-Ray Center, P.C*. (8th Cir. 1998) 146 F.3d 593, 594-95 (radiology); *Ins. Corp. of Ireland, Ltd. v. Board of Trustees of S. Illinois Univ*. (7th Cir. 1991) 937 F.2d 331, 338 (University's refusal to let faculty members practice at hospital); *Tire Kingdom, Inc. v. First S. Ins. Co*. (Fla. Dist. Ct. App. 1990) 573 So.2d 885 (tire industry).

• California Business & Professions Code section 17200. *Align Technology, Inc. v. Federal Ins. Co*. (N.D. Cal. 2009) 673 F.Supp.2d 957, 969-73.

• Conspiracy to circulate anti-aerosol publicity intended to result in aerosol product boycott and drive claimant out of business. *Ruder & Finn Inc. v. Seaboard Sur. Co*. (1981) 52 N.Y.2d 663, 422 N.E.2d 518.

• Discrimination, slander of title, and unreasonable restraint of trade in marketing residential real property. *Lime Tree Village Cmty. Club Ass'n, Inc. v. State Farm Gen. Ins. Co*. (11th Cir. 1993) 980 F.2d 1402, 1406-07.

• Discriminatory payments in violation of Robinson-Patman Act. *Westchester Fire Ins. Co. v. G. Heileman Brewing Co*. (Ill.App.Ct. 2001) 747 N.E.2d 955.

• Discriminatory pricing practices in beer distribution. *Federal Ins. Co. v. Stroh Brewing Co*. (7th Cir. 1997) 127 F.3d 563, 568.

• Interference with bank lines of credit. *Bankwest v. Fidelity & Deposit Co. of Maryland* (10th Cir. 1995) 63 F.3d 974, 981.

• Monopoly power and antitrust violations by bridge player for suspension from play. *Am. Contract Bridge League v. Nationwide Mut. Fire Ins. Co*. (3d Cir. 1985) 752 F.2d 71, 75.

• Patent infringement. *DISH Network Corp. v. Arch Specialty Ins. Co*. (10th Cir. 2011) 659 F.3d 1010, 1013-27; *Hyundai Motor Am. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA* (9th Cir. 2010) 600 F.3d 1092, 1097-1104.

• Pollution. *Titan Holdings Syndicate, Inc. v. City of Keene* (1st Cir. 1990) 898 F.2d 265.

• Producing and selling counterfeit National Football League jerseys. *Hudson Ins. Co. v. Colony Ins. Co*. (9th Cir. 2010) 624 F.3d 1264, 1268-70.

• Race discrimination claim. *Clinton v. Aetna Life & Cas. Co*. (Conn.Super.Ct.

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1991) 41 Conn.Supp. 560 [594 A.2d 1046].

• Sale of counterfeit cigarettes. *Capitol Indem. Corp. v. Elston Self Serv. Wholesale Groceries, Inc*. (7th Cir. 2009) 559 F.3d 616, 617-19.

• Tortious interference with prospective advantage based on disparagement by alleged co-conspirator that could make insured liable under civil conspiracy theory. *Travelers Property Cas. Co. of Am. v. Hillerich & Bradsby Co*. (6th Cir. 2010) 598 F.3d 257, 262-64, 272-73.

• Trade dress infringement and unfair business practices for producing, advertising, and selling an allegedly cloned product line that diluted the brand of the original product line. *Bridge Metal Indus., L.L.C. v. Travelers Indem. Co*. (S.D.N.Y. Sept. 7, 2011) 2011 U.S. Dist. LEXIS 101093.

• Unlawful possession of tenants' apartment and personal property therein by changing the locks on the apartment. *Spodek v. Liberty Mut. Ins. Co*. (1989) 155 A.D.2d 439, 547 N.Y.S.2d 100, 102-03.

• Wrongful termination of lease and for punitive damages awarded as a result of tenant's wrongful eviction. *Providence Washington Ins. Co. v. City of Valdez* (Alaska 1984) 684 P.2d 861.

Even if the causes of action or the words in a complaint do not trigger a defense duty, the inquiry does not end there. The determination of whether there is a duty to defend is not limited to a simple examination of the allegations in or potential liability posed by a complaint. Instead, an insurer must consider facts and evidence outside of the complaint itself:

> [F]acts known to the insurer and extrinsic to the third party complaint can generate a duty to defend, even though the face of the complaint does not reflect a potential for liability under the policy. This is so because current pleading rules liberally allow amendment; the third party plaintiff cannot be the arbiter of coverage.

(*Montrose*, 6 Cal.4th at 296. See also *Horace Mann*, 4 Cal.4th at 1081 ["Facts extrinsic to the complaint also may give rise to a duty to defend when they reveal the possibility that the claim may be covered by the policy."])

Once a duty to defend is established, an insurer is limited in its efforts to escape from that duty. An insurer also cannot "properly avoid its duty to defend by relying upon a coverage defense related to a critical issue in the underlying lawsuits, to wit, that there was no 'occurrence' during the policy period . . ." (*County of San Bernardino v. Pacific Indemnity Co*. (1997) 56 Cal.App.4th 666.) It also cannot point to the existence of a factual dispute as a defense to coverage. (See, e.g., *Mirpad, LLC v. California Ins. Guar. Ass'n* (2005) 132 Cal.App.4th 1058 ["if coverage depends on an unresolved dispute over a factual question, the very existence of that dispute would establish a possibility of coverage and thus a duty to defend."])

In fact, if an insurer files a coverage lawsuit against its insured to adjudicate its duties, or forces the insured to file a coverage action to obtain a defense duty, the insured may have the coverage action stayed to avoid prejudicing the defense of the underlying lawsuit. In that situation, the insurer may be held to have a duty to defend until the underlying lawsuit is resolved:

> To eliminate the risk of inconsistent factual determinations that could prejudice the insured, a stay of the declaratory relief action pending resolution of the third party suit is appropriate when the coverage question turns on facts to be litigated in the underlying action. For example, when the third party seeks damages on account of the insured's negligence, and the insurer seeks to avoid providing a defense by arguing that its insured harmed the third party by intentional conduct, the potential that the insurer's proof will prejudice its insured in the underlying litigation is obvious. This is the classic situation in which the declaratory relief action should be stayed.

(*Montrose*, 6 Cal.4th at 301-02.)

Likewise, an insurer cannot avoid its duty to defend by arguing that claim against its insured has no merit, and therefore the insured will prevail in the underlying lawsuit:

> [A]n insurer cannot avoid the duty to defend merely by concluding, based on its own investigation, that the insured has done no wrong. The duty to defend does not evaporate simply because the insurer has decided that the insured will ultimately be exonerated (or because evidence supporting that conclusion has been introduced in a declaratory relief action over coverage). Indeed, the duty of defense . . . covers third party claims that are "groundless, false or fraudulent." . . . In short, an insurer's determination that an insured is not liable on a third party claim does not provide a basis for escaping the duty to defend. That duty extends to those insureds whom the insurer believes to be innocent of the conduct alleged in the third party complaint.

(*A&H Plating, Inc. v. Am. Nat'l Fire Ins. Co*. (1997) 57 Cal.App.4th 427, 442-43; see *Garriott Crop Dusting Co. v. Superior Court* (1990) 221 Cal.App.3d 783, 796 [duty to defend exists "regardless of potentially meritorious defenses to [underlying] claims" and insurer must defend until resolution of underlying lawsuit].)

Furthermore, an insurer cannot rely on an exclusion in its policy to defeat its duty to defend unless it shows, "through conclusive evidence, that the exclusion applies in all possible worlds." (*Atl. Mut. Ins. Co. v. J. Lamb, Inc*. (2002) 100 Cal.App.4th 1017, 1038-39.) And, an insurer cannot prevail on an exclusion even if its interpretation of that exclusion is reasonable, unless it establishes that its interpretation "is the only reasonable one." (*MacKinnon v. Superior Court* (2003) 31 Cal.4th 635, 655.)

Indeed, the defense duty continues even after a lawsuit results in a judgment against an insured solely on a non-covered ground an insurer remains obligated to pay for the insured's defense through the resolution of the lawsuit. As one court of appeal explained: "Just because evidence has closed in the underlying case does not mean the facts against the policyholder have necessarily calcified. Here, a new trial might have been granted. Witnesses might have changed their stories or their memories might have improved. The . . . judgment against [the insured] could

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have been overturned, yet another takes its place on remand. In short, the potential for indemnification liability continued into the appeal period." (*Prichard v. Liberty Mut. Ins. Co*. (2000) 84 Cal.App.4th 890, 903-04.)

Finally, once an insurer's duty to defend is triggered, it cannot escape by pointing to the actions of other insurers that also may have a duty to defend, even if those other insurers have acknowledged their defense duty. As the California Supreme Court has held, "Where more than one insurer owes a duty to defend, a defense by one constitutes no excuse of the failure of any other insurer to perform. (*Wint v. Fidelity & Cas. Co*. (1973) 9 Cal.3d 257, 263.) An insurer also cannot honor its duty to defend by paying only for part of the insured's defense premised on the notion that other insurers also have a duty to defend. Indeed, an insurer's offer to pay only a share of the insured's defense is "the equivalent of a defense denial. Such a unilateral limitation of [an insurer's] responsibility is not justified. If it owes any defense burden it must be fully borne . . . with allocation of that burden among other responsible parties to be determined later." (*Haskel, Inc. v. Superior Court* (1995) 33 Cal.App.4th 963, 976 n.9. See also *Aerojet-Gen. Corp. v. Transport Indem. Co*. (1997) 17 Cal.4th 38, 70 ["the insurers each had a duty to defend all the . . . actions in their entirety – to be precise, each had such a duty separate and independent from the other."]) And, of course, an insurer cannot escape from its duty by pointing to the non-performance by other insurers of their independent duties to defend. "Simply put, as a mother might say to her child, just because other insurers do it, does not necessarily make it right." (*Lance Camper Mfg. Corp. v. Republic Indem. Co. of Am*. (2001) 90 Cal.App.4th 1151, 1156.)

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