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Leslie L. Roos

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By LESLIE L. ROOS*

IN EVERY policy of liability insurance there will be found a clause in the insuring agreements generally providing that "as respects such insurance as is afforded by the terms of this policy, the company shall defend in his name and behalf any suit against the insured alleging (a claim covered by the policy) and seeking damages on account thereof even if such suit is groundless, false, or fraudulent; but the company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient." This clause gives the company the right to control the settlement of claims and the litigation resulting therefrom and imposes upon it the correlative obligation to furnish at its own expense an attorney selected by it to defend its insured. The insured is required to cooperate with the company in the defense of the claim as the obligation to defend and the right to control go hand in hand. It has generally been assumed that the company is obligated only to defend those actions with respect to which, in the event of an adverse judgment, it would be obliged under the coverage provided to indemnify the assured. What are the tests for determining whether or not the claim is one which is covered by the policy? What risks does the company run in refusing to defend a claim where doubt as to coverage exists? With what ethical problems is the attorney retained by the company confronted where it does defend such a doubtful claim?

Risks Involved in Refusing to Defend

The company is faced with a difficult choice when the problem arises. In at least one California decision the court frankly stated that where "semantically permissible"[1] it would interpret an insurance policy to afford coverage. An insurance company which refuses to defend a claim made against its insured upon the grounds that the claim does not fall within its coverage, acts at its peril. If it makes an incorrect decision, the consequences are serious. The caliber of the defense

* A.B. 1934, Stanford University; LL.B. 1937, Harvard University; member, San Francisco and California bars; American Bar Association.

[1] Continental Cas. Co. v. Phoenix Constr. Co., 46 Cal. 2d 423, 437, 296 P.2d 801, 809 (1956).

provided by the insured personally may be inadequate and the company has given up its right to control the defense. If the insured is without funds he may not even put up a defense. If the company has guessed wrong, it may ultimately have to pay a judgment considerably larger than it would have had to pay had it defended through its own counsel. Whether the defense provided by the insured was successful or unsuccessful, the company will be liable for his attorney's fees and defense costs.[2] The insured may settle the case and the company will be obligated to reimburse him for any reasonable settlement.[3]

If, on the other hand, the company assumes the defense without properly protecting its rights (of which more anon) it will be held to have waived or to be estopped from asserting later the defense of non-coverage.[4] However, the company may adequately protect itself by entering into a so-called "non-waiver" or "reservation of rights" agreement with the insured provided it obtains his express or implied consent.[5] However, the insured may expressly refuse to agree to the reservation, in which case the company is forced to elect whether to defend and thereby waive possible defenses including non-coverage, or to refuse to defend and stand the consequences if it is ultimately held to have guessed incorrectly.[6]

The Test to Determine Coverage

What is the test to answer the question of coverage or no coverage? The general rule is that the factual allegations of the complaint are to be analyzed and if the gravamen of the cause of action states a claim within the coverage provisions of the policy, then the company owes a duty to defend the insured, but not otherwise.[7]

That inroads would be made upon this rule which would not be to the liking of the insurance industry was apparent in *Ritchie v. Anchor Cas. Co.*,[8] where the court stated:[9]

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[2] Arenson v. National Auto. & Cas. Ins. Co., 48 Cal. 2d 528, 310 P.2d 961 (1957).

[3] Walters v. American Ins. Co., 185 Cal. App. 2d 776, 8 Cal. Rptr. 665 (1960).

[4] 29A AM. JUR. *Insurance* § 1465 (1960); see Sears v. Illinois Indem. Co., 121 Cal. App. 211, 9 P.2d 245 (1932).

[5] Note, 68 HARV. L. REV. 1436 (1955); 2 STAN. L. REV. 383 (1950).

[6] Schmidt v. National Auto. & Cas. Ins. Co., 207 F.2d 301 (8th Cir. 1953); Hawkeye Cas. Co. v. Stover, 154 Neb. 466, 48 N.W.2d 623, 50 A.L.R.2d 463 (1951).

[7] Remmer v. Glens Falls Indem. Co., 140 Cal. App. 2d 84, 295 P.2d 19 (1956); Lamb v. Belt Cas. Co., 3 Cal. App. 2d 624, 40 P.2d 311 (1935); Greer-Robbins v. Pacific Sur. Co., 37 Cal. App. 540, 174 Pac. 110 (1918).

[8] 135 Cal. App. 2d 245, 286 P.2d 1000 (1955).

[9] *Id.* at 250, 286 P.2d at 1003-04.

> Respondent contends and we agree, that the insurer's obligation to defend is measured by the terms of the insurance policy and the pleading of the claimant who sues the insured. . . .
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> Examination of the pleading reveals that it does factually allege an accident though it does not use that word. The draftsman of a complaint against the insured is not interested in the question of coverage which later arises between insurer and insured. He chooses such theory as best serves his purpose; if it be breach of contract rather than negligent performance of contract, he chooses the former; if it be negligence rather than warranty he alleges negligence; if he happens to choose warranty it may be an express one or one implied. And when the question later arises under an insurance policy as to what the facts alleged in the complaint do spell, . . . for instance, whether they aver an accident, . . . the complaint must be taken by its four corners and the facts arrayed in a complete pattern without regard to niceties of pleading or differentiation between different counts of a single complaint. And the ultimate question is whether the facts alleged do fairly apprise the insurer that plaintiff is suing the insured upon an occurrence which, if his allegations are true, gives rise to liability of insurer to insured under the terms of the policy.
>
> It is settled that "in case of doubt such doubt ought to be resolved in the insured's favor." . . . In the *Pow-Well* case, which depended upon a showing of an accident arising out of a plumber's operations, the court said with reference to a complaint leaving the matter in doubt: "In such a situation, it would seem to be the duty of the insurer to defend, if there is, potentially, a case under the negligence complaint, within the coverage of the policy. If, under the negligence complaint, a claim could be proved, which the insurer must pay, the duty to defend arises."

It was always clear that where the allegations in the complaint were ambiguous or open to two interpretations, one within and one without the policy, the doubt would be resolved against the company,[10] and that where the complaint alleged two causes of action, one of which was within the coverage of the policy and the other without, the company was bound to defend, at least until it appeared that the claim was not covered.[11] Where the complaint alleges facts outside the policy but the company knows or could find out that the true facts present a claim which is covered by the policy, there is a conflict of authority on the obligation to defend.[12]

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[10] 29A AM. JUR. *Insurance* § 1454 (1960).

[11] *E.g.*, Lee v. Aetna Cas. & Sur. Co., 178 F.2d 750 (2d Cir. 1949); 50 A.L.R.2d 506-07; 41 A.L.R.2d 434-35.

[12] *Compare* Hardware Mut. Cas. Co. v. Hilderbrandt, 119 F.2d 291 (10th Cir. 1941), *with* Goldberg v. Lumber Mut. Cas. Ins. Co., 297 N.Y. 148, 77 N.E.2d 131 (1948), 50 A.L.R.2d 498. Where the complaint alleges facts which would be within the policy but the known facts negate coverage the claim probably must be defended under the "groundless, false or fraudulent" clause: United States Fid. & Guar. Co. v. Yazoo Cooperage Co., 157 Miss. 27, 127 So. 579 (1930).

Firco *and* Walters–*Two Unusual California Cases*

It is, however, extremely doubtful that anyone anticipated two extraordinary California decisions. *Firco, Inc. v. Firemen's Fund Ins. Co.*[13] concerned an action commenced against Firco by Pacific Lumber Company alleging that Firco had entered upon the lumber company's lands and "maliciously, wantonly, and without leave" removed several hundred feet of redwood and Douglas fir trees from the lumber company's land. The complaint prayed for treble damages. Since a wilful and malicious cause of action was alleged, the company understandably, refused to defend. Firco commenced an action for declaratory relief. A judgment for the defendant company was reversed on appeal and the supreme court denied a hearing. The district court of appeal completely abandoned the "allegations of the complaint test" without saying so and cited none of the earlier cases which established this rule in California. The complaint filed by Pacific Lumber Company was neither uncertain nor ambiguous. Nor did the court indicate that the true facts, irrespective of the lumber company's allegations, fell within the policy coverage. The court makes no reference to section 533 of the Insurance Code, which provides that "An insurer is not liable for a loss caused by a wilful act of the insured." This section codifies the general rule that an insurance policy purporting to indemnify the assured against liability due to his own wilful wrong is void as against public policy.[14] Without citation of any authority whatsoever, the court found that the obligation to defend was owed since:[15]

> Under our liberal rules of pleading it is settled that if the facts alleged in a complaint entitle the plaintiff to any relief, such relief will be accorded, notwithstanding it may appear from the pleading or during the course of the action that the plaintiff cannot receive relief under his theory of the action. . . . The allegations in the complaint do not justify a conclusion that respondent is not obligated to defend, for it may turn out in the course of the action that the entry was unintentional and yet the plaintiff in the Humboldt action would be entitled to recover at least the value of the trees taken. It must be remembered that the attorney who drafted the complaint in the Humboldt action is not concerned with the relations between the defendant and any insurer that may be obligated to pay the judgment. He drafts his complaint as broadly as he desires. In the Humboldt action, the plaintiff's attorney cast his complaint in such manner as to warrant the recovery of treble damages under section 3346 of the Civil Code if he could prove that the nature of the wrong and the manner of its infliction could be shown to entitle plaintiff to such damages under the provisions of that section. But if it should turn out that the man-

[13] 173 Cal. App. 2d 524, 343 P.2d 311 (1959).

[14] Arenson v. National Auto. & Cas. Ins. Co., 45 Cal. 2d 81, 286 P.2d 816 (1955).

[15] 173 Cal. App. 2d at 529, 343 P.2d at 314.

> ner of inflicting the wrong came within the exception provided in that section, which disallows treble damages "where the trespass was casual and involuntary, or committed under the belief that the land belonged to the trespasser," then plaintiff could obtain only actual damages.

In other words, the company was held obligated to defend because it was *possible,* even though remotely so, that at some time during the course of the trial the plaintiff *might* elect to change the entire theory of his complaint (and a trial judge *might* permit him to do so) by amending to state a cause of action for negligence rather than for an intentional tort. Later cases either ignore *Firco*[16] or cite it without seeming recognition of its implications.[17]

Even more unusual is the case of *Walters v. American Ins. Co.*,[18] an action for declaratory relief and damages. A claim had been made against the insured for assault and battery. The carrier of his personal liability policy refused to have anything to do with the claim since assault and battery is an intentional act. The insured settled with the claimant for 6,000 dollars in order to protect his credit reputation which would have been impaired had a law suit been filed. He thereupon brought an action for declaratory relief against the company. The trial court's judgment for the defendant was reversed on appeal and judgment directed for the plaintiff for 6,000 dollars upon the ground that the insured had acted in self-defense and was, therefore, not liable for the assault and battery. A hearing by the supreme court was denied. This opinion, interestingly enough, does not cite *Firco* and restates the general rule that the obligation to defend is measured by the allegations of the complaint. It neatly gets around this proposition by stating: "Here there was no action or pleading by [the claimant], whereby the insurer's duty to defend would be measured. That question, therefore, is open in this proceeding and should be resolved against defendant on the basis of our interpretation of the exclusion provision."[19] Would a different result have been reached had the insured permitted a suit to be filed rather than making a settlement before suit?[20] The com-

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[16] Walters v. American Ins. Co., 185 Cal. App. 2d 776, 8 Cal. Rptr. 665 (1960); Liberty Bldg. Co. v. Royal Indem. Co., 177 Cal. App. 2d 583, 2 Cal. Rptr. 329 (1960).

[17] Columbia Southern Chem Corp. v. Manufacturers & Wholesalers Indem. Exch., 190 Cal. App. 2d —, 11 Cal. Rptr. 762 (1961).

[18] 185 Cal. App. 2d 776, 8 Cal. Rptr. 665 (1960).

[19] *Id.* at 785, 8 Cal. Rptr. at 671.

[20] Would not his credit have been equally impaired had the company defended under a reservation of rights stating that it would not settle or pay an adverse judgment since assault and battery is an intentional tort? It is submitted that it was not the refusal to *defend* the threatened suit that impaired the insured's credit.

plaint, if filed, would have alleged an intentional assault and battery with no reference to the defense of self-defense.

It has always been understood that the insurance company was obliged to defend only those actions in which it would be obligated to satisfy an adverse judgment in order to indemnify the insured. In the *Walters* case, as has been pointed out,[21] the company would not have been obligated to satisfy an adverse judgment against its insured since, had the plaintiff prevailed, the policy would have afforded no coverage.[22]

By applying *Firco* to *Walters*, one comes to the inescapable conclusion, illogical and unintended as it may be, that every assault and battery case against an individual carrying the usual personal liability policy must be defended by the insurance company until judgment because somewhere along the line the insured may contend that he acted in self-defense using no more force than was reasonable, and a jury may believe him. It is submitted that a supreme court decision re-examining the entire problem is required. If *Firco* and *Walters* are the law in California today there is no standard or logical test for determining whether or not an insurance company is or is not obligated to defend its insured where a doubtful question of coverage is presented, when the obligation terminates, and how the attorney retained by the company may ethically protect his regular client.

Ethical Problems of the Attorney

Interesting ethical problems confront the attorney retained by the insurance company in those cases where the company is defending a case where coverage is questionable and it has not waived the defense. For example:

(a) The complaint alleges two causes of action, one of which alleges facts within the coverage provisions and the other of which alleges facts without the coverage provisions. Let us compound this problem further by assuming that in complete good faith the attorney feels that the best opportunity for obtaining a defense verdict is to emphasize and seek to establish the facts which are not within policy coverage.

(b) If *Firco* is the law then "the duty to defend the action arose when the action was begun and will continue until in the proceedings in that case it certainly appears that the claim cannot eventuate in a

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[21] Note, 49 CALIF. L. REV. 394 (1961).

[22] Had the company defended and an adverse judgment resulted, would the insured have been obligated to reimburse the company for its costs of defense? If not, wouldn't at least the spirit of CAL. INS. CODE § 533 be violated?

judgment which the insurer is obligated to pay."[23] Is the attorney retained by the insurance company to attempt to withdraw at the conclusion of the plaintiff's case when it clearly appears that "the claim cannot eventuate in a judgment which the insurer is obligated to pay"? Or, is he obliged to put on a defense, then attempt to withdraw prior to the submission of the case to the jury? If he attempts to withdraw at any of these stages, has he violated his duties to the insured? If he does not, has he violated his duty to the company by placing it in a position where it will later he held to have waived or be estopped from asserting the defense of non-coverage?[24]

The attorney's duty is clearly set forth in *Pennix v. Winton.*[25]

> In assuming to act as counsel for [the insured] . . . in this action, counsel assumed toward [the insured] . . . the high duties imposed by statute, (Business and Profession Code, section 6068) and by the rules governing professional conduct (Rules of Professional Conduct, 213 Cal. page cxiii), and whenever counsel had reason to believe that the discharge of those duties would conflict with the discharge of counsel's duties to the insurance carrier, it became the duty of counsel to take appropriate steps to terminate the relationship.

It is easier to state this duty than to live up to it.[26] Were counsel to "terminate the relationship" would not his successor be confronted with the same conflict? The use of separate attorneys for the company and the insured has been suggested as a solution of the conflict question.[27] This is of doubtful practicability since the attorney for the plaintiff would undoubtedly object to more than one attorney for the defendant examining witnesses and there would be a conflict as to which attorney should control the conduct of the trial. Another impractical solution involving "the use of a three-party suit, in which insurer, assured, and injured claimant can each press its own view" has been suggested to cover the situation:[28]

> [W]here the claimant alleges that the assured injured him negligently and alternately that the injury was intentionally inflicted, the assured would attempt to prove his freedom from fault while the insurer might attempt to prove an intentional tort. Since it is likely that the injured claimant will be pressing primarily for a finding of

[23] Firco, Inc. v. Firemen's Fund Ins. Co., 173 Cal. App. 2d 524, 529, 343 P.2d 311, 314 (1959).

[24] See 29A AM. JUR. *Insurance* § 1468 (1960); Note, *supra* note 5 at 1445.

[25] 61 Cal. App. 2d 761, 773, 143 P.2d 940, 946 (1943).

[26] Certain things cannot be done, *e.g.*, Pennix v. Winton, 61 Cal. App. 2d 761, 143 P.2d 940 (1943); Hammett v. McIntyre, 114 Cal. App. 2d 148, 249 P.2d 885 (1952); O'Morrow v. Borad, 27 Cal. 2d 794, 167 P.2d 483 (1946).

[27] Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1167-76 (1954).

[28] Note, *supra* note 5 at 1451.

> negligence, because only that ground will give him the right to collect from the insurer, the jury may make one of three possible findings, each of which will bind all the parties.

This suggestion would require legislation, complicate the issues, bring the existence of insurance in full view, and be time-consuming and expensive.

The attorney representing the insurance carrier is the one primarily concerned with the conflict of interest problem. It is believed that no solution can be devised which will apply to all cases. If the insured and the company are unable to resolve the problem between themselves and present a united front so that both may concentrate upon winning the personal injury action, the least unsatisfactory solution of a case involving doubt as to coverage is probably an action for declaratory relief to be tried prior to the trial of the personal injury action.[29] Care should be taken to join the injured claimant as a party defendant since, if he is not joined, the declaratory judgment will not be res judicata as to him.[30]

At best the problem is a difficult and vexatious one for all concerned.

[29] See State Farm Ins. Co. v. Superior Court, 47 Cal. 2d 428, 304 P.2d 13 (1956) where separate trials of the declaratory relief and injury actions were directed but the order thereof left to the discretion of the trial court.

[30] Shapiro v. Republic Indem. Co., 52 Cal. 2d 437, 341 P.2d 289 (1959).