

# THE DUTY TO DEFEND WHEN DOES IT END?

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Insurers must often provide a defense to a policyholder on the barest of allegations, but at least in some jurisdictions, there can be rest for the weary: While a duty to defend may be required initially, extrinsic evidence can be used to terminate the defense. In many jurisdictions, however, the task of obtaining a court order allowing withdrawal from the defense may be difficult, if not impossible.

An insurer's duty to defend typically is triggered based on the policy terms and the allegations of the complaint. Under the oft-mentioned "8 corners rule," if the claim stated in the underlying complaint, without amendment, could impose liability for conduct covered by the insurance policy, the insurer has a duty to defend the claim. The

duty arises if the complaint provides any basis for which the insurer provides coverage.

In federal court and many state court jurisdictions, a pleading must merely include a short and plain statement of the claim. A plaintiff need not allege all the facts giving rise to a cause of action, and may assert claims in broad, general terms. This can impose a significant burden on an insurer to determine if there are any facts in the pleadings that could conceivably give rise to a duty to defend. The allegations alone may not provide an insurance carrier with enough information to determine with certainty whether a defense must be provided. In such jurisdictions, the insurer must investigate the facts and, when in doubt, provide a defense to the insured.

In states such as California, the sweet with the bitter for insurers is that the company and the court need not "avert their eyes" from undisputed facts that can eliminate a defense obligation. In *Montrose Chemical Corp. v. Superior Court*, 6 Cal. 4th 287, 861 P.2d 1153, 24 Cal. Rptr.2d 467 (1993), the Supreme Court of California quoted with approval the following statement of the lower court:

[N]either logic, common sense, nor fair play supports a rule allowing only the insured to rely on extrinsic facts to determine the potential for coverage. It would be pointless, for example, to require an insurer to defend an action where undisputed facts developed early in the investi-

gation conclusively showed, despite a contrary allegation in the complaint, that the underlying acts occurred on a date when the policy was not in effect or at a location concededly not covered by the policy. Similarly, where extrinsic evidence establishes that the ultimate question of coverage can be determined as a matter of law on undisputed facts, we see no reason to prevent an insurer from seeking summary adjudication that no potential for liability exists and thus that it has no duty to defend. We see the critical distinction as not whether extrinsic evidence may be considered, but whether such evidence presents undisputed facts which conclusively eliminate a potential for liability.

The court summed up that to prevail, the insured must prove the existence of a potential for coverage, while the insurer must establish the absence of any such potential. In other words, the insured need only show that the underlying claim may fall within the policy coverage; the insurer must prove it cannot.

Insurers litigating in courts in California and other jurisdictions that follow the approach in *Montrose* can avoid the effects of innovative pleading by a plaintiff's lawyer. In instances where counsel has purposefully avoided pleading inconvenient facts that might adversely affect the duty to defend and indemnify the defendant-insured, an insurer can bring suit for a judgment declaring that the defense can be withdrawn based on extrinsic evidence showing the absence of any potential for coverage.

There may be more chances in coming years for insurers to withdraw from the defense in construction defect cases. Many modern commercial general liability insurance policies include exclusions with respect to property damage that occurred or arose out of defective construction work that existed prior to the inception of the policy. One such exclusion is the "Continuous or Progressive Injury or Damage Exclusion," which typically provides as follows:

This insurance does not apply to any damages because of or related to bodily injury or property damage:

1. Which first existed, or is alleged to have first existed, prior to the inception date of this policy;
2. Which are, or are alleged to be, in the process of taking place prior to the inception date of this policy, even if the actual

or alleged bodily injury or property damage continues during this policy period, or

3. Which were caused, or are alleged to have been caused, by the same condition or construction defect which resulted in bodily injury or property damage which first existed prior to the inception date of this policy.

We shall have no duty to defend any insured against any loss, claim, or suit or other proceeding alleging damages arising out of or related to bodily injury or property damage to which this endorsement applies.

This exclusion is said to have been created in reaction to a companion case to the *Montrose* case discussed above, *Montrose Chemical Corp. v. Admiral Ins. Co.*, 10 Cal. 4th 645, 913 P.2d 878, 42 Cal. Rptr.2d 324 (1995), in which the court adopted the "continuous injury trigger of coverage" for claims of continuous or progressively deteriorating damage or injury under third party CGL policies.

It is frequently the case that a review of the construction contracts, invoices and completion notices shows that the work complained of was completed several years before the policy inception date. Commonly in such situations, counsel for a project owner bringing suit against the developers and contractors for damages from construction defects will omit from the complaint any dates of construction or completion. In this way, prior work exclusions are not implicated, and the insured may be entitled to a defense, at least initially, to which it might not otherwise be entitled were the dates of construction mentioned in the pleading.

In the *Montrose*-type jurisdictions discussed above, terminating a defense for insurers whose policies included prior work exclusions should be a straight-forward matter of bringing an action for declaratory relief and seeking summary judgment finding no duty to defend based on undisputed, extrinsic evidence to support the prior work exclusion.

This option is not available everywhere, however. In Washington state, for example, an insurer must investigate the facts and, where appropriate, provide a defense, but an insurer cannot use extrinsic evidence to avoid the defense. In the recent case of *Navigators Ins. Co. v. K&O Contracting LLC*, 2013 U.S. Dist. LEXIS 171392 (D. Or. Dec. 4, 2013), the United States District Court for the District of Oregon held that even in the face of undisputed extrinsic evidence

that the insured's construction work was completed prior to the policy inception date, the evidence could not be considered to terminate the insurer's duty to defend.

In that case, Navigators had brought an action for declaratory relief and offered admissions from the insured regarding the dates of construction. The court noted that under Oregon law, extrinsic evidence could not be considered at all, absent certain very limited circumstances that were not present in the case. The magistrate discussed cases from other courts in which the duty to defend can be terminated based on undisputed evidence of no coverage, going so far as to state that "the prevailing view may seem the most reasonable and logical." But, in the absence of specific authority in Oregon, the magistrate held, and the district judge agreed, that the relief sought by Navigators could not be granted.

The prohibition on considering extrinsic evidence to allow an insurer to avoid the defense allows owners' lawyers to omit with impunity any facts which are not relevant to their clients' claims but which may significantly impact an insurers' defense and indemnification duties. The consequence is that insurers end up defending claims for which there will never be a duty to indemnify. This trend will continue until there is a change in law in such jurisdictions.



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