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## The Duty to Defend Clause in a Liability Insurance Policy: Should the Exclusive Pleading Test Be Replaced?

David A. Garbett

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# COMMENTS

## The Duty to Defend Clause in a Liability Insurance Policy: Should the Exclusive Pleading Test Be Replaced?

DAVID S. GARBETT\*

*The author analyzes the insurer's duty to defend and the judicial dilemma in choosing between the exclusive pleading test and the factual test in the determination whether the duty exists in each of six possible fact paradigms. The author critically examines the rationale underlying the selection of either test within each paradigm, and suggests a foundation upon which courts should base their resolution of the conflict.*

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## I. INTRODUCTION

The standard liability insurance policy contains two related promises undertaken by the insurer. First, in the "primary coverage" or "indemnity" clause, the insurance company agrees to pay all covered claims and judgments against the insured.<sup>1</sup> The insurance company also obligates itself to defend any suit brought against the insured that alleges and seeks damages for a covered injury, even if the allegations of the complaint are groundless, false, or fraudulent. These "indemnity" and "duty to defend" clauses are substantially the same in all American liability insurance policies.<sup>2</sup> The two clauses interrelate because the insurer is promising to defend and indemnify against only those claims which are within the policy's coverage.<sup>3</sup> In addition, most insur-

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1. A covered claim is typically an "occurrence" such as "an accident, including injurious exposure to conditions, which results, during the policy period, in bodily injury or property damage neither expected nor intended from the standpoint of the insured." *National Union Fire Ins. Co. v. Lenox Liquors, Inc.*, 358 So. 2d 533, 535-36 (Fla. 1977) (emphasis deleted).

2. A typical insurance policy contains the following provision:

The company will pay on behalf of the *insured* all sums which the insured shall become legally obligated to pay as *damages* because of

A. *bodily injury* or

B. *property damage*

*to which this insurance applies*, caused by an *occurrence*, and the company shall have the right and duty to defend any suit against the *insured* seeking damages on account of such *bodily injury* or *property damage*, even if any of the allegations of the suit are groundless, false or fraudulent, and may make such investigation and settlement of any claim or suit as it deems expedient, but the company shall not be obligated to pay any claim or judgment or to defend any suit after the applicable limit of the company's liability has been exhausted by payment of judgments or settlements.

7C J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4682, at 22 n.9 (1979) (emphasis added).

3. Even though the clauses are related because they both depend on covered claims, courts view these provisions as distinct obligations. As stated in 44 AM. JUR. 2D *Insurance* § 1539, at 420-21 (1969):

The duty to defend does not depend upon the insurer's liability to pay, however, since the insurer's duty to defend stems from its own contractual obligation to the insured, while its ultimate liability to pay on behalf of the insured depends upon the law of negligence, and since the usual policy provisions requiring the insurer to defend cannot be construed to impose such a duty only in the case of successful suits against the insured. Accordingly, the insurer may be obligated to defend although not held liable to pay. In other words, the insurer may be obli-

ance policies also contain express exclusions for events that are beyond the scope and coverage of the policy.

When the allegations of the complaint against the insured set forth facts outside the scope of a policy's primary coverage, or facts that fall under an exclusionary provision which negates coverage, the insurer will generally have no duty to defend. The converse of this proposition does not obtain, however. Although the insurer may have no duty to defend a particular action, it still may be liable under the primary coverage clause to indemnify the insured against an adverse judgment.<sup>4</sup>

If the insurer breaches its duty to defend, it is liable for the insured's costs of defending the underlying lawsuit, including reasonable attorney's fees. As a result, the insurer's interests are in avoiding the costs of defending a suit that it has no obligation to defend, and in avoiding potential liability when it makes an erroneous determination regarding its duty to defend.<sup>5</sup> The insurer therefore seeks a precise rule to distinguish between those suits it must defend and those it may refuse to defend without subsequently incurring liability. Further, the insurer prefers to reach its decision promptly so that it can assume control of the insured's defense.<sup>6</sup> The insured similarly has an interest in a clear rule to determine when the insurer must undertake its duty to defend. Having paid the policy premium, the insured believes it is entitled to this representation and desires advance knowledge of the scope of its rights as a policyholder against the insurer.

This article discusses and analyzes the various rules that have developed for determining whether an insurer has a duty to defend. While the initial focus is on Florida law, this article also takes a multijurisdictional approach and attempts to formulate specific rules for a number of identifiable fact situations in this area of insurance law.

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gated to defend so-called "groundless" suits—namely, suits the allegations of which bring them within the coverage of the policy, but which are decided in favor of the insured.

(footnotes omitted).

4. *Green v. Aetna Ins. Co.*, 349 F.2d 919, 925 (5th Cir. 1965).

5. An insurance company declines a tender of defense at its own peril, for if the court later finds that the insurer's refusal was wrongful, the insurer will be liable for the insured's cost of defense. *See, e.g., Tennessee Corp. v. Lamb Bros. Constr. Co.*, 265 So. 2d 533 (Fla. 2d DCA 1972).

6. Typically, an insurer's experienced counsel can more capably minimize the magnitude of adverse judgments than can independent counsel for the insured.

## II. AN OVERVIEW: THE EXCLUSIVE PLEADING AND FACTUAL TESTS

The traditional rule for determining the insurer's duty to defend is that if the allegations of the complaint against the insured state facts that fairly bring the claim within the policy's coverage, the insurer has a duty to defend, even if those allegations are groundless, false, or fraudulent. Stated differently, the allegations of the complaint against the insured solely govern the insurer's duty to defend; the rule precludes the court's consideration of unpleaded actual facts.

The language of the duty to defend clause in the insurance policy is the basis of the rule. The typical provision reads: "LIABILITY COVERAGE: . . . [T]he company shall defend any suit *alleging* such bodily injury or property damage<sup>7</sup> and seeking damages which are payable under the terms of this policy, even if any of the allegations of the suit are groundless,<sup>8</sup> false, or fraudulent . . . ."<sup>9</sup> Insurers interpret this language to mean that the parties intended that the allegations of the complaint against the insured control the duty to defend.<sup>10</sup> Thus, the complaint must *allege* facts that when fairly read bring the cause of action within the policy's cover-

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7. "Property damage" usually refers to actual physical damage. Accordingly, an insurer has no duty to defend a garage that lost a lock seat mechanism from a customer's car, because the loss does not constitute "property damage" under the garage's liability insurance policy. *Patriot Gen. Ins. Co. v. Automobile Sales, Inc.*, 372 So. 2d 187 (Fla. 3d DCA 1979).

8. Even though the insurer promises to defend "groundless" suits, this promise does not obligate an insurer to defend a claim that would be beyond the policy's coverage if the claimant prevailed. See *Burd v. Sussex Mut. Ins. Co.*, 56 N.J. 383, 267 A.2d 7 (1970). This conclusion is based on the meaning of "groundless" as used in liability policies. As the court in *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962), explained:

The groundless suit which the insurer undertakes to defend is a suit containing unsupportable allegations which on their face show coverage by the policy of the liability asserted against the insured . . . . Whether or not the insured could be liable to the injured claimant under the true facts is not determinative of the groundlessness of the suit. For example, a suit is brought alleging injury and damage arising out of the use of the insured automobile. In truth the automobile involved was another automobile owned by the insured and not covered by the policy. This is a groundless suit because the allegations show coverage, even though the insured may, or may not, be personally liable under the true facts. . . . "But a distinction must be drawn between groundless suits and actions which, even if successful would not be within the policy coverage."

*Id.* at 291, 127 S.E.2d at 56-57 (quoting 7A J. APPLEMAN, *INSURANCE LAW AND PRACTICE* § 4684, at 448).

9. *Ging v. American Liberty Ins. Co.*, 293 F. Supp. 756, 758 (N.D. Fla. 1968) (emphasis added).

10. See, e.g., *Travelers Ins. Co. v. Newsom*, 352 S.W.2d 888, 893 (Tex. Civ. App. 1961). The argument is rather unpersuasive since these provisions are part of standard form contracts written by insurance companies.

age. Once the allegations trigger coverage, and the resulting duty to defend, it is irrelevant that those allegations prove to be false, fraudulent, or groundless.<sup>11</sup> Because the pleadings exclusively govern the duty to defend, this rule is labeled the "exclusive pleading test."

There exists an exception to the exclusive pleading test: When a variance develops between the *untrue* alleged facts activating an exclusion and the unpleaded *actual* facts triggering coverage, the actual facts should govern the duty to defend. Courts<sup>12</sup> and commentators<sup>13</sup> have noted the conflict between these polar views—the exclusive pleading test and its exception, the factual test. The object of this article is to demonstrate how courts have applied these two rules in different factual settings, and to analyze which standard is more appropriate for determining whether a duty to defend exists.

### III. THE ORIGIN OF THE EXCLUSIVE PLEADING TEST

The seminal case of *Lee v. Aetna Casualty & Surety Co.*<sup>14</sup> firmly established the traditional rule for determining the existence of the insurer's duty to defend. In *Lee* the plaintiff entered the insured proprietor's pet shop to purchase a monkey. Because the monkeys were located on the fifth floor, the proprietor escorted the plaintiff to the elevator, raised a protective gate, and invited him inside. The plaintiff complied but fell to the bottom of the

11. The rule is stated in 7C J. APPLEMAN, *supra* note 2, § 4683, at 42:

An insurer's duty to defend an action against the insured is measured, in the first instance, by the allegations in the plaintiff's pleadings, and if such pleadings state facts bringing the injury within the coverage of the policy, the insurer must defend, irrespective of the insured's ultimate liability to the plaintiff.

12. *Green v. Aetna Ins. Co.*, 349 F.2d 919, 923 (5th Cir. 1965) (applying Texas law); *American Policyholders' Ins. Co. v. Cumberland Cold Storage Co.*, 373 A.2d 247, 250 n.1 (Me. 1977) (the most logical rule is one that predicates the duty to defend on the complaint's allegations, even when the insurer has knowledge of contrary facts); *Isenhardt v. General Casualty Co. of Am.*, 233 Or. 49, 54, 377 P.2d 26, 28 (1962); *Travelers Ins. Co. v. Newsum*, 352 S.W.2d 888, 890 (Tex. Civ. App. 1961).

13. Dahoney, *The Liability Insurer's Duty to Defend*, 33 BAYLOR L. REV. 451 (1981). See generally Comment, *The Insurer's Duty to Defend Under a Liability Insurance Policy*, 114 U. PA. L. REV. 734 (1966); Note, *Use of the Declaratory Judgment to Determine a Liability Insurer's Duty to Defend—Conflict of Interests*, 41 IND. L.J. 87 (1965); Note, *Liability Insurer's Duty to Defend: American Policyholders' Ins. Co. v. Cumberland Cold Storage Co.*, 30 ME. L. REV. 295 (1979); Note, *The Insurer's Duty to Defend Made Absolute: Gray v. Zurich*, 14 U.C.L.A. L. REV. 1328 (1967); 30 N.Y.U. L. REV. 1019 (1955); 2 STAN. L. REV. 383 (1950); 5 WILLAMETTE L.J. 321 (1969); 6 WM. MITCHELL L. REV. 473 (1980); Annot., 50 A.L.R.2D 458 (1956).

14. 178 F.2d 750 (2d Cir. 1949) (L. Hand, J.).

shaft.<sup>15</sup> The insurance policy in question contained a duty to defend clause and several policy exclusions, one of which excluded coverage for liability arising from the use of the elevator.<sup>16</sup> After concluding that this exclusion applied,<sup>17</sup> and that the insurer owed no duty to indemnify the proprietor, Judge Learned Hand analyzed the duty to defend clause.

The clause read as follows: "[Insurer promises to] defend \* \* \* any suit against the Insured *alleging* injury, sickness, disease or destruction *covered by this Policy* \* \* \* even if such suit is groundless, false or fraudulent."<sup>18</sup> In construing this language, Judge Hand articulated the general rule:

This language means that the insurer will defend the suit, if the injured party states a claim, which, qua claim, is for an injury "covered" by the policy; *it is the claim which determines the insurer's duty to defend*; and it is irrelevant that the insurer may get information from the insured, or from anyone else, which indicates, or even demonstrates, that the injury is not in fact "covered."<sup>19</sup>

Thus, the insurer's duty to defend depends solely on the scope of the allegations against the insured. If those allegations fall within the policy's coverage, the insurer must defend, even though the actual facts negate coverage, because the insurer has expressly promised to defend against all alleged covered claims, even if groundless, false, or fraudulent.<sup>20</sup>

In holding that the insurer owed a duty to defend, the court in *Lee* observed that by merely comparing the complaint's allegations to the policy's coverage, one could not determine whether the policy covered the alleged injury.<sup>21</sup> The insurer therefore was obli-

15. *Id.* at 751. For a more detailed discussion of the facts, see *Lee v. Aetna Casualty & Sur. Co.*, 81 F. Supp. 1008, 1010 (S.D.N.Y. 1949).

16. 178 F.2d at 751.

17. The court concluded that the insured's action of inviting the plaintiff into the elevator constituted a "use" of the elevator. Accordingly, the injured party's claim was within the exclusionary provision of the policy. *Id.*

18. *Id.* (emphasis added).

19. *Id.* (emphasis added).

20. For a detailed discussion of this point, see *infra* notes 33-36 & 254-55 and accompanying text.

21. As the court observed: "[T]he complaint covered an injury which might, or might not, have happened from the insured's 'use' of the elevator . . ." 178 F.2d at 752. Indeed, one could characterize this finding by the court as the operative fact in a narrow holding: If the allegations of the complaint are inadequate or inconclusive respecting the duty to defend, the insurer must defend, at least until it can confine the claim to a noncovered event. Many courts have not read the *Lee* holding restrictively and in fact, have cited much of the

gated to defend until it could confine the claim to a noncovered event.<sup>22</sup>

American jurisprudence traditionally has supported the exclusive pleading test formulated in *Lee* for several reasons. First, some courts observe that the rule is practical and efficient.<sup>23</sup> The insurer need only place the complaint alongside the policy, and if any of the allegations are within its coverage, the insurer must defend the lawsuit.<sup>24</sup> Conversely, if the complaint shows noncoverage or the applicability of a policy exclusion,<sup>25</sup> the insurer may safely decline the defense of the action. Other courts<sup>26</sup> that have adhered

*Lee* dicta so extensively that *Lee* now stands for several different propositions. See *infra* note 50 and accompanying text.

22. 178 F.2d at 753. A recent citation of the rule is found in *Oliver B. Cannon & Son v. Fidelity & Casualty Co.*, 484 F. Supp. 1375 (D. Del. 1980) (applying Pennsylvania law). The court stated the Pennsylvania rule as follows:

[W]here the insurance contract obligates the insurer to defend the insured against some of the claims in a complaint, the insurer must also defend against other claims of the complaint which do not fall within the coverage of the policy until the litigation reaches the point where it would be impossible to recover on any of the claims falling within the coverage of the policy.

*Id.* at 1385.

23. See, e.g., *Ross Island Sand & Gravel Co. v. General Ins. Co.*, 472 F.2d 750 (9th Cir. 1973):

Since . . . procedural law [in a Code pleading jurisdiction] requires a complaint to state the facts which constitute the cause of action, a relatively simple and businesslike rule calls upon the insurer to study that complaint and then to undertake the defense any time the complaint alleges facts which, if proven at trial, would or could give rise to liability under any theory of law creating a liability covered by the insuring agreement.

*Id.* at 752.

24. *Shaw v. Aetna Casualty & Sur. Co.*, 407 F.2d 813 (7th Cir. 1969); *Steyer v. Westvaco Corp.*, 450 F. Supp. 384 (D. Md. 1978); *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220 (Me. 1980) (termed the method the "comparison test"); *Kyllo v. Northland Chem. Co.*, 209 N.W.2d 629 (N.D. 1973). The comparison test loses its efficacy, however, when the complaint is ambiguous as to coverage or the applicability of an exclusion. See *infra* notes 158-96 and accompanying text.

25. See, e.g., *Amundsen v. Great Cent. Ins. Co.*, 451 S.W.2d 277 (Tex. Civ. App. 1970). In *Amundsen* the court, applying the exclusive pleading test, compared the allegations of the complaint with the insurance policy. It found that the complaint fell within a policy exclusion, and consequently the insurer had no duty to defend. The insured argued that the "exception" to the traditional rule applied. The court concluded, however, that Texas did not recognize the exception and moreover, there was no variance between the alleged and actual facts.

26. See, e.g., *Travelers Ins. Co. v. Newsom*, 352 S.W.2d 888 (Tex. Civ. App. 1961). The court in *Newsom* reached what it called the "logical conclusion":

We pose the question: Why is the duty of the insurer to defend determinative of the allegations in the third party's complaint? We answer our own question with the very logical conclusion that the contract so provides wherein its [sic] says, "the company shall defend any suit against the insured alleging such injuries \* \* \*." That is the coverage paid for by the insured.



to the exclusive pleading test argue that the traditional view is the more logical approach, because the policy language simply states that the insurer will defend any suit *alleging* a covered injury. Thus, the parties presumably intend that the allegations should control the duty to defend; the courts should refuse to rewrite the policy or read into it an additional duty to investigate the truthfulness of the underlying complaint.<sup>27</sup> Another court has argued persuasively that if the insurer were required to look beyond the face of the complaint in determining its duty to defend, the insurer would have to speculate whether the plaintiff could prove the alleged facts.<sup>28</sup> Moreover, if the court were to look beyond the complaint, and analyze the proof of actual facts, then the court could not determine the insurer's duty to defend until after the underlying trial's completion.<sup>29</sup>

#### IV. THE DUTY TO DEFEND IN FLORIDA

##### A. *The Exclusive Pleading Test*

As a general rule, Florida follows the exclusive pleading test in determining the existence of the insurer's duty to defend. One of

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*Id.* at 893 (emphasis in original).

Evidently, the court felt bound by the policy language and would not rewrite the duty to defend clause to include a duty to investigate statements that the insured or anyone else may have made. Whether this conclusion was justified is explored in detail, *infra* notes 218-36 and accompanying text. See also *infra* note 123 and accompanying text.

27. 352 S.W.2d at 893.

28. *Isenhart v. General Casualty Co. of Am.*, 233 Or. 49, 54, 377 P.2d 26, 28-29 (1962). Perhaps this reasoning best accounts for the general principle that the duty to defend is broader than the duty to indemnify. The duty to defend is based on the *alleged* facts, whether true or false. Accordingly, the insurer must defend all *alleged covered* claims. The duty to indemnify, on the other hand, will only exist if the plaintiff's claim is *proved* to be a covered occurrence. This, of course, will only occur after trial. See *infra* note 97.

29. Once the insurer has declined to defend the underlying lawsuit, the insured may bring a declaratory judgment action in which the suit's actual facts will be proved. The parties may litigate the duty to defend prior to the commencement of the underlying suit against the insured. This provides support for the rule that the actual facts should govern the duty to defend. One court has noted, however, that the availability of declaratory judgment actions should not alter the traditional rule:

If we were to look beyond the complaint and engage in proof of actual facts, then the separate declaratory judgment actions . . . would become independent trials of the facts which the [insured] would have to carry on at his expense. Moreover, once an inquiry begins into the actual facts, the insured will have already begun defending against liability, and the issue in respect to the insurer will be its ultimate duty to indemnify, not its duty to defend. We see no reason why the insured, whose insurer is obligated by contract to defend him, should have to try the facts in a suit against his insurer in order to obtain a defense. *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220, 227 (Me. 1980).

the earliest Florida cases to deal with the duty to defend was *New Amsterdam Casualty Co. v. Knowles*.<sup>30</sup> The insured, a convalescent home, sought a declaratory judgment to establish the insurer's obligation to defend a suit brought by an injured patient. The patient's complaint alleged injuries sustained as a result of the negligence of an attendant in the insured's employ.<sup>31</sup> Upon investigation the insured learned that when the attendant made his rounds, he had found the bed bars down and the patient on the floor. The insured surmised that the patient's injury was accidental. After the insurer conducted its own investigation, it declined to defend the suit because a policy exclusion denied coverage for claims "resulting from the rendering of any professional services or omission thereof."<sup>32</sup> The insurer argued that the actual facts revealed by its investigation activated the policy exclusion, relieving the insurer of an obligation to defend. The Supreme Court of Florida rejected this contention. It held that since the allegations of the complaint indicated the possibility of coverage,<sup>33</sup> the insurer had a duty to defend, notwithstanding the possibility that the actual facts ascertained by the insurer<sup>34</sup> or established at trial<sup>35</sup> would come within an exclusion and relieve the insurer of its duty to indemnify.<sup>36</sup> In

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30. 95 So. 2d 413 (Fla. 1957).

31. The plaintiff apparently injured himself when he fell out of bed. *Id.* at 414.

32. *Id.* at 413.

33. See *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949).

34. The *Lee* court concluded that if the complaint comprehends an injury that "may be" within the policy, then the insurer is obligated to defend. *Id.* at 753. The court explained:

This language [the duty to defend provision] means that the insurer will defend the suit, if the injured party states a claim, which, qua claim, is for an injury "covered" by the policy; it is the claim which determines the insurer's duty to defend; and it is irrelevant that the insurer may get information from the insured, or from any one else, which indicates, or even demonstrates, that the injury is not in fact "covered."

*Id.* at 751 (emphasis added).

35. See, e.g., *Accredited Bond Agencies, Inc. v. Gulf Ins. Co.*, 352 So. 2d 1252 (Fla. 1st DCA 1977). In *Accredited* the underlying complaint alleged an employment relationship between Duggs, a bail bonds agent, and the insured, a bail bonds company. The policy covered actions by the insured's employees. At trial the actual facts established that Duggs was an independent contractor whose actions were not covered by the policy. The trial judge ruled that because no coverage existed, there could be no duty to defend. The appellate court reversed and held that the allegations which triggered a duty to defend controlled, despite the existence of facts falling within the exclusion. See *infra* notes 242-64 and accompanying text.

36. As the court concluded, "If there actually existed a set of facts so different as to, relieve the appellant from liability, that would be developed only in an eventual trial. But the appellant could not meanwhile decline any participation in the action." 95 So. 2d at 415.

In *Klaesen Bros. v. Harbor Ins. Co.*, 410 So. 2d 611 (Fla. 4th DCA 1982), the plaintiff

short, the court refused to give credence to the insurer's investigation or to allow the insurer to decide for itself whether a duty to defend existed:

When we undertake to reason that an insurance company may issue a policy . . . and insure for a price, against the loss from hazards incident to the operation, and then arrogate to itself the right of deciding that, after all, an injury with which no one except an attendant seems to have had any connection, resulted from professional services, hence responsibility to defend did not arise, we come full cycle in our thinking.<sup>37</sup>

The decisions in *Knowles* and subsequent cases<sup>38</sup> clearly established that in order to determine the insurer's duty to defend, courts should consider exclusively the complaint's allegations in light of the policy coverage. If the allegations contained facts which, if proved, would establish the insurer's obligation to indemnify under the policy, then the insurer has a duty to defend.<sup>39</sup>

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sued the insured, the owner and operator of a carnival attraction, for the wrongful death of Mr. Hardison caused by the insured's employee, Pitts. The complaint merely alleged that Pitts acted within the scope of his employment and that his job required him to sleep on the premises. The actual facts revealed that Pitts was hired to erect rides and that he had shot Hardison following a drunken barroom brawl at 3:00 a.m., well after the carnival was closed for the evening. The insurer argued that since the insured denied that Pitts was acting within the scope of his employment, no coverage and consequently no duty to defend could arise. The court rejected the contention, holding that once the complaint alleges facts within coverage, the duty attaches and the actual facts are only relevant to the duty to indemnify. *Id.* at 613.

37. 95 So. 2d at 415.

38. *See, e.g., Bennett v. Fidelity & Casualty Co.*, 132 So. 2d 788 (Fla. 1st DCA 1961). In *Bennett* the insured brought a declaratory judgment action to determine whether its insurer had to defend against a suit claiming that the insured had caused flood damage to business property. The property owners charged that the insured's negligent and willful reconstruction of a dam was the proximate cause of flooding on the owners' land after a heavy rain. The policy provided that the insurer "would pay on behalf of the insured all sums which the insured should become legally obligated to pay as damages because of injury to or destruction of property 'caused by accident,' [and would] defend any suit . . . alleging such injury or destruction . . ." *Id.* at 789 (emphasis added). Thus, the duty to defend depended on whether there was a covered claim, i.e., whether an accident caused the alleged injury.

In concluding that rain in South Florida was not "unexpected" from the standpoint of the insured and therefore was not an "accident," the court relied on the exclusive pleading test: "[A] public liability carrier's duty to defend the insured in an action brought against him is to be determined from the allegations of the complaint, declaration, or other statement of the cause of action, filed in such action against the insured." *Id.* at 790.

39. This conclusion follows even though the allegations of the complaint are only partially within the policy's coverage. *See, e.g., American Hardware Mut. Ins. Co. v. Miami Leasing & Rentals*, 362 So. 2d 28 (Fla. 3d DCA 1978); *Stevens v. Horne*, 325 So. 2d 459 (Fla. 4th DCA 1975); *Travelers Indem. Co. v. Thomas*, 315 So. 2d 111 (Fla. 1st DCA 1975), *cert. denied*, 336 So. 2d 108 (Fla. 1976); *Garden Sanctuary, Inc. v. Insurance Co. of N. Am.*, 292 So. 2d 75 (Fla. 2d DCA 1974); *St. Paul Fire & Marine Ins. Co. v. Hodor*, 200 So. 2d 205 (Fla.

In Florida the exclusive pleading test controls when the complaint either triggers coverage or indicates the applicability of a policy exclusion.<sup>40</sup> The latter possibility occurred in *Consolidated Mutual Insurance Co. v. Ivy Liquors, Inc.*,<sup>41</sup> when a customer instituted a lawsuit against the insured liquor store for injuries resulting from an alleged assault and battery committed by the store manager. The policy provided that the insurer would defend any suit alleging an injury that resulted from an accident, "including assault and battery unless committed by or at the direction of the insured."<sup>42</sup> The insurer withdrew from the case after its investigation revealed that the policy did not cover the incident. Relying on the exclusive pleading test, the court found that the store manager committed the assault in furtherance of the insured's business and concluded that the assault did not constitute an "accident" within the meaning of the policy.<sup>43</sup> No duty to defend existed because the claim *as alleged* fell within a policy exclusion.<sup>44</sup>

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3d DCA 1967).

*Stevens v. Horne* involved a union employees' strike against Southern Bell Telephone Company. When Horne, a nonunion employee, crossed the picket line, several striking members taunted him and displayed a sign entitled "Ted Horne, Super Scab." Horne brought suit alleging that the union was either vicariously liable for the conduct of its members who were acting as its agents, servants, or employees, or directly liable because it had directed its members' acts. When the insurer declined to defend the insured union, the insurer was impleaded as a third-party defendant. On appeal the court held that the insurer had a duty to defend the entire suit if one of the alleged alternate theories of liability stated facts bringing the injury within the policy's coverage. 325 So. 2d at 461. *But cf.* *Battisti v. Continental Casualty Co.*, 406 F.2d 1318 (5th Cir. 1969) (applying Florida law, the court held that the complaint against the insured failed to aver any facts partially within and outside the policy's coverage).

40. *Battisti v. Continental Casualty Co.*, 406 F.2d at 1321 (citing 7A J. APPLEMAN, INSURANCE LAW AND PRACTICE § 4683, at 445 n.37 (2d ed. 1962)).

41. 185 So. 2d 187 (Fla. 3d DCA 1966).

42. *Id.* at 188. Several courts have found this provision inherently ambiguous because the clause offers coverage for assault and battery as being within the definition of "accident," and simultaneously excludes assault and battery if committed by, or at the direction of, the insured. Moreover, the clause does not contain language of exclusion but rather of affirmation. *See Lowell v. Maryland Casualty Co.*, 65 Cal. 2d 298, 419 P.2d 180, 54 Cal. Rptr. 116 (1966).

43. 185 So. 2d at 189; *accord* *Briscoe v. Travelers Indem. Co.*, 18 Wash. App. 662, 571 P.2d 226 (1977) (insurer declined to defend because injuries sustained in alleged assault and battery did not constitute an "accident" within terms of policy). Not all jurisdictions agree on this point. *See infra* notes 125-56 and accompanying text.

44. 185 So. 2d at 189; *see also* *Louisville Title Ins. Co. v. Guerard*, 409 So. 2d 514 (Fla. 5th DCA 1982) (insurer had no duty to defend complaint that sought to establish a prescriptive easement since title insurance policy excluded such claims); *Continental Casualty Co. v. Schaubel*, 380 So. 2d 483 (Fla. 3d DCA 1980) (charges against insured for libel, slander, and invasion of privacy were within policy exclusion); *Federal Ins. Co. v. Applestein*, 377 So. 2d 229 (Fla. 3d DCA 1979) (insurer had no duty to defend because allegations of intentional

### B. Policy Exclusions: Where the Exclusive Pleading Test Fails

One of the major criticisms of the exclusive pleading test stems from the application of the test to policy exclusions.<sup>45</sup> Most, if not all, insurance policies contain some sort of exclusionary provision precluding coverage for certain acts. Although these exclusionary provisions vary with the type of policy involved, they all contain language stating in essence that intentional injuries caused by the insured are not covered risks. Accordingly, if the injured plaintiff alleges an intentional act, without also alleging negligence,<sup>46</sup> the exclusive pleading test compels the court to rule prior to the underlying trial that no duty to defend exists. Several courts and commentators<sup>47</sup> have argued that this is unjust: Injured plaintiffs typically allege an intentional injury, even if only negligence is involved, in order to provide a predicate for the recovery of punitive damages. Then, if the evidence does not support the plaintiff's claim of an intentional injury, the plaintiff can change his theory during the trial to conform to the evidence by amending his complaint<sup>48</sup> to include a negligent injury, absent prejudice to the op-

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injury against insured clearly indicated a policy exclusion); *Prieto v. Continental Ins. Co.*, 358 So. 2d 851 (Fla. 3d DCA 1978) (allegations of complaint demonstrated applicability of policy exclusion for "completed operations"); *Atkins v. Bellefonte Ins. Co.*, 342 So. 2d 837 (Fla. 3d DCA 1977) (insurer had no duty to defend because automobile collision fell within policy exclusion denying coverage for ownership or use of an automobile); *Buchwald v. Hartford Accident & Indem. Co.*, 319 So. 2d 164 (Fla. 3d DCA 1975) (insurer had no duty to defend suit alleging willful assault and battery because policy expressly excluded coverage for intentional torts). For a more extensive discussion of whether an alleged exclusion should automatically negate a duty to defend, see *infra* notes 125-56 and accompanying text.

45. An exclusion can take two forms: either the claim does not fall within the policy definition of "occurrence" or "accident," or a list of enumerated events in the policy expressly excludes the claim from coverage.

46. Of course, if the complaint contains allegations of fact within as well as outside of coverage, the insurer is obligated to defend the entire suit. See *supra* cases cited note 39.

47. Comment, *supra* note 13.

48. If the plaintiff amends his complaint to include an allegation of negligence, and the insured properly notifies the insurer, then the insurer must undertake defense at that point. If the insurer refuses, it will be liable for the costs of defense incurred after the application to amend the complaint. *St. Paul Fire & Marine Ins. Co. v. Hodor*, 200 So. 2d 205 (Fla. 3d DCA 1967); cf. *C.A. Fielland, Inc. v. Fidelity & Casualty Co.*, 297 So. 2d 122 (Fla. 2d DCA 1974) (although the duty to defend is determined initially from the allegations of the complaint, if it later appears that the plaintiff is pursuing covered claims not originally pleaded, the insurer must defend on proper notification). *But cf. Sussman v. American Sur. Co.*, 345 F.2d 679 (5th Cir. 1965) (original complaint in personal injury action did not allege facts within coverage, and insurer was neither notified of the amended complaint nor given an opportunity to defend on the merits; insurer not liable for default judgment entered against insured).

posing party.<sup>49</sup> The exclusive pleading test, therefore, poses problems for all parties because the original complaint may not accurately reflect the theory upon which the injured party may ultimately proceed against the insured.<sup>50</sup>

The shortcoming of the exclusive pleading test is even more evident when the insured party notifies his insurer that the injury was accidental, despite the complaint's contrary allegations of intentional injury, and the insurer could ascertain the true facts after a reasonable investigation. *Capoferri v. Allstate Insurance Co.*<sup>51</sup> exemplifies the unfairness that can result from the rigid application of this rule. The insured, Mr. Capoferri, pleaded guilty in traffic court to police charges of careless driving, stemming from an accident with an automobile driven by Mr. Dimon. Soon thereafter, Dimon brought suit against the insured, alleging that Capoferri willfully assaulted him by deliberately colliding with his automobile. The complaint sought compensatory and punitive damages. Capoferri notified his insurer of Dimon's complaint and gave a sworn statement that the collision occurred when his foot accidentally slipped off the brake and struck the accelerator.<sup>52</sup> The insurer

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49. FLA. R. CIV. P. 1.190(b).

50. This principle may also work in favor of the insurer. If a portion of the claim is within coverage, the insurer must defend *until the covered portion is eliminated from the suit*. *Buckner v. Physicians Protective Trust Fund*, 376 So. 2d 461 (Fla. 3d DCA 1979); *C.A. Fielland, Inc. v. Fidelity & Casualty Co.*, 297 So. 2d 122, 127 (Fla. 2d DCA 1974) (dictum); *cf. Babcock & Wilcox Co. v. Parsons Corp.*, 430 F.2d 531 (8th Cir. 1970) (applying Nebraska law) (plaintiff's answers to insured's interrogatories did not unequivocally narrow claim to one excluded by policy). *But cf. Kings Point West, Inc. v. North River Ins. Co.*, 412 So. 2d 379 (Fla. 2d DCA 1982) (once complaint triggers duty to defend, subsequent filings indicating noncoverage do not negate the defense obligation).

51. 322 So. 2d 625 (Fla. 3d DCA 1975).

52. *Id.* at 626. Capoferri's statement triggered coverage. Later, when the insurer examined the bare allegations of Dimon's complaint, it withdrew its defense because the charges activated the exclusionary provisions of the policy. The court in *Capoferri* disregarded the insured's sworn statement as irrelevant to the determination of the insurer's duty to defend.

In *St. Paul Fire & Marine Ins. Co. v. Thomas*, 273 So. 2d 117 (Fla. 4th DCA 1973), the opposite fact situation existed. In *Thomas* the underlying complaint indicated coverage; the insured's version, corroborated by a fellow passenger, fell within the policy exclusion. The *Thomas* court concluded that once the complaint triggered coverage and a duty to defend, information received from the insured or anyone else does not obviate the duty. Thus, once the duty to defend exists *because of* the complaint, the duty attaches and is not terminated by the actual facts *negating* coverage because the insurer promises to defend groundless, false, or fraudulent suits. *Id.* at 119 n.2; *see Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750, 751 (2d Cir. 1949) (L. Hand, J.) ("[A]nd it is irrelevant that the insurer may get information from the insured, or from anyone else, which indicates, or even demonstrates, that the injury is not in fact 'covered.'"); *see also Kings Point West, Inc. v. North River Ins. Co.* 412 So. 2d 379 (Fla. 2d DCA 1982) (insurer breached its duty to defend when it wrongfully

initially undertook the defense, but then declined any further representation on the ground that the policy excluded intentional injuries.<sup>53</sup> The insured retained private counsel, who answered the plaintiff's complaint and filed a third-party action against the insurer, seeking indemnity for any judgment against the insured and the costs of defending the principal action.

A jury tried the main action and returned a verdict for the insured. The trial court, however, granted the insurer's motion for summary judgment on the third-party complaint. On appeal, the insured argued that an insurer cannot lawfully withdraw its representation on the bare allegations of a complaint that charges an intentional injury, especially when the insurer has substantial evidence from its own investigation to show that either the lawsuit is groundless<sup>54</sup> or the plaintiff will prevail on a covered claim.<sup>55</sup>

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refused tender of complaint alleging a covered event, even though later filings showed non-coverage); *Klaesen Bros. v. Harbor Ins. Co.*, 410 So. 2d 611 (Fla. 4th DCA 1982) (insurer had duty to defend wrongful death action alleging employee had acted within scope of his employment, despite the contrary actual facts); *supra* notes 32-36 and *infra* notes 242-64 and accompanying text.

In all standard liability insurance policies, as in *Capoferri*, the defense clause's language specifically covers a situation in which the complaint *triggers* coverage, but the defense clause is otherwise silent on the possibility of false or groundless allegations falling within an exclusion. The rationale of *Capoferri* is therefore based on the negative implication of the policy language. Some courts have refused to interpret the policy in this manner, holding that *false* allegations of an *excluded* event will not relieve the insurer of a defense obligation. *See, e.g., Conner v. Transamerica Ins. Co.*, 496 P.2d 770, 775 (Okla. 1972). Courts are divided on the question whether the insured's version of the incident is relevant to the determination of a defense obligation. *Compare Maryland Casualty Co. v. Knorpp*, 370 S.W.2d 898, 902 (Tex. Civ. App. 1963) (Chapman, J., concurring) (court erred in considering insured's affidavit along with third-party complaint) *with United States Fire Ins. Co. v. Schnabel*, 504 P.2d 847, 850 n.7 (Alaska 1972) (insurer must give weight to insured's version of incident contained in his answer, if version appears reasonable). *But see Carolina Aircraft Corp. v. American Mut. Liab. Ins. Co.*, 517 F.2d 1076 (5th Cir. 1975) (applying Florida law, court held that plaintiff's complaint, not insured's answer, governs duty to defend).

53. 322 So.2d at 626.

54. *Id.* It is important to examine briefly the language of a duty to defend clause, which usually binds the company to defend any suit alleging an injury that is covered by the policy, even if the allegations are groundless, false, or fraudulent. Properly construed, this language means that the insurer has a positive duty to defend if the allegations include a covered claim, even if those allegations are groundless, false, or fraudulent. But the converse of the proposition—that if the allegations indicate an *exclusion*, the company need *not* defend, even if these allegations are groundless, false, or fraudulent—does not necessarily and logically follow from the policy's language. Indeed, as to this factual setting the rights of the parties seem ambiguous. *See infra* notes 201-05 and accompanying text; *see also Conner v. Transamerica Ins. Co.*, 496 P.2d 770 (Okla. 1972) (groundless allegations of an exclusion did not relieve insurer of defense obligation).

55. 322 So. 2d at 626. As to policy exclusions for injuries caused intentionally by the insured, Florida courts distinguish between intentional acts and intentional injuries. Thus, even if the act is intentional, it does not necessarily follow that the injury is intentional, as

The District Court of Appeal, Third District, rejected this contention and mechanically applied the exclusive pleading test. The court reasoned that since the complaint alleged only a cause of action for an intentional act, which was excluded from coverage, the insurer would not be required to defend because it would not be bound to indemnify.

This reasoning, as applied to the facts of *Capoferri*, is flawed. As a general proposition, the duty to defend is considered distinct from, and broader than, the duty to indemnify. Thus many courts will require an insurer to defend if there is a "potential" of coverage arising from the alleged facts. Under this approach, *actual* coverage need not be shown. In *Capoferri*, then, the court should have found a duty to defend since the alleged facts certainly showed a "potential" of coverage. One could reasonably surmise from the complaint that the collision could have been due to Capoferri's negligent driving.

Conversely, when the complaint contains *no* potential for coverage, because it involves a claim which by its nature necessarily and inexorably falls within an exclusion, then the insurer should not have to defend. Thus, in *Louisville Title Insurance Co. v. Guerard*,<sup>56</sup> the complaint sought a prescriptive easement, which the policy expressly excluded from coverage. The court properly held that the insurer had no duty to defend, in that there was no potential for coverage. The claim inescapably fell within the policy exclusion because the plaintiff could not recover on a lesser theory or amend the complaint to allege a claim within coverage.

### C. The "Exception" to the Exclusive Pleading Test

Although Florida courts generally follow the exclusive pleading test, a few have looked beyond the complaint to the actual facts in determining whether an insurer is obligated to defend. *Tennessee Corp. v. Lamb Brothers Construction Co.*<sup>57</sup> involved a claim for damages resulting from the allegedly negligent operation of a tractor during land clearing operations. An explosion inter-

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intentional acts can result in unintended consequences. If the injury is not intended, the exclusion will not absolve the insurer of its duty to indemnify. See, e.g., *Phoenix Ins. Co. v. Helton*, 298 So. 2d 177 (Fla. 1st DCA 1974) (while intentionally driving into a crowd to reach his wife, insured struck and broke a bystander's hand; although the act was intentional, the injury was not).

56. 409 So. 2d 514 (Fla. 5th DCA 1982). For a more extensive discussion of the concept of "potentiality," see *infra* notes 65, 120-21, 139-44 & 149 and accompanying text.

57. 265 So. 2d 533 (Fla. 2d DCA 1972).



rupted the flow of natural gas to the plaintiff, Tennessee Corporation, forcing it to close its manufacturing plant.

Lamb Brothers, the insured, joined its insurer as a third-party defendant, demanding indemnification and recovery of the costs of defending the action. The insurance policy covered any injury or destruction resulting from land clearing operations, but excluded coverage if the damage occurred during land grading operations. After the court concluded that the exclusion was not ambiguous,<sup>58</sup> it addressed the issue of the duty to defend. The court refused to apply the general rule that the allegations of the complaint govern the duty to defend,<sup>59</sup> because the complaint failed to specify whether the insured was performing land clearing or land grading operations.<sup>60</sup> Thus, the duty to defend was to depend on the actual facts established on remand:

[S]ince the allegations in the *complaint* do not initially solve the question posed in this case, we believe the responsibility *vel non* to defend must now depend solely on the operation which, assuming causal connection, was *in fact* being performed at the time of the accident. If that operation was grading, which is within the exclusion, there was no duty to defend; if it was a non-excluded aspect of land clearing then the insurance company declined to defend at its own risk, and it would now be liable for the costs of such defense because under its contract it should have defended. We now see the importance in this case of making a determination of how and under what circum-

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58. The trial court found no difference between land clearing and land grading; accordingly, it refused to enforce the exclusion. The appellate court disagreed, noting that land grading simply involves the leveling or contouring of land, while land clearing includes the uprooting of trees and other vegetation, drainage operations, and sometimes land grading. *Id.* at 537.

59. "[A] liability carrier must defend its insured if the initial pleadings *fairly* bring the case within the scope of coverage even though, ultimately, there is no liability." *Id.* (emphasis added).

60. *Id.* at 538; *cf.* *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949) (involving the same fact pattern as *Lamb Bros.*). Since the complaint in *Lee* was ambiguous, the court could not determine from the allegations whether the facts fell under the policy exclusion—the "use" of an elevator. The court, however, resolved the issue in favor of the insured and found a duty to defend:

[A]ny complaint, though its language may cover two or more events, is meant to advise the defendant of only one event, unless two separate events create separate liabilities. The "intended" event is that on which the injured party means to rely; and, although he has not made it plain whether it is within the class of events covered by the policy, it either is or is not within that class. His allegation leaves its membership in that class open, but the class of the event he is talking about is definitely fixed.

*Id.* at 752.

stances the accident in fact occurred . . . .<sup>61</sup>

Although the court in *Lamb Brothers* did not expressly refer to any "exception" to the exclusive pleading test, it recognized, at least implicitly, that an exception applies when the allegations are inadequate to determine whether a duty to defend exists.<sup>62</sup> In such a case the court is not confined to the allegations in the complaint, but may instead examine the objective facts to determine the defense obligation.<sup>63</sup>

The United States Court of Appeals for the Fifth Circuit similarly applied the "exception" in *Rowell v. Hodges*.<sup>64</sup> In *Rowell* the plaintiff's complaint alleged injuries caused by the insured in a car accident, but the complaint did not specify the year and make of the insured's car. The insurer learned through investigation that the car involved in the accident was not the one covered by the policy. The insured argued that the exclusive pleading test limited the court to the allegations of the complaint and that the actual facts which the insurer discovered were irrelevant. The insurer maintained that the exclusive pleading test did not apply because one could not ascertain from the complaint whether coverage existed; the duty to defend therefore depended on the actual facts. The court agreed and held that under Florida law the insurer had no duty to defend because the vehicle was not actually covered:

[T]o say here that the [insurer] must gauge its obligation strictly by the pleading called a Complaint, and put blinders on, so to speak, to what it actually knows and has definitely ascertained, is somewhat archaic, considering the nature of our present system of notice pleading. The Court simply cannot find any just or logical reason why it should be held that the mere allegation by

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61. 265 So. 2d at 538 (emphasis in original).

62. See *infra* text accompanying notes 158-96.

63. See also *Florida Farm Bureau Mut. Ins. Co. v. Rice*, 393 So. 2d 552 (Fla. 1st DCA 1980). In *Rice* a collision occurred between a motorcycle on which Rice was riding and a Pontiac driven by the insured. Rice sued Eichholz, who notified his insurer, Farm Bureau. Eichholz's policy expressly covered a pickup truck and "any automobile" unless owned by the insured or available for his regular use. The complaint, of course, did not include information that would establish coverage. When Eichholz first told Farm Bureau that his mother-in-law owned the Pontiac, it denied coverage on the ground that the mother-in-law was a member of Eichholz's household and the car was available for his regular use. Later, however, Eichholz stated that his mother-in-law had given him the car just before she left town and that the car had been inoperative until a day before the accident. Consequently, the car was not furnished to him "for regular use." Based upon these facts, which Eichholz later established at trial, the court held that the insurer had breached its duty to defend and was liable for defense costs and the consent judgment entered against the insured.

64. 434 F.2d 926 (5th Cir. 1970).

the Plaintiffs that [the insured] was operating "an automobile" thereby invokes a contractual obligation to defend the suit by the Plaintiffs, when reality, i.e., the actual identity of the vehicle involved in the accident, told everybody that there was not and never had been any insurance coverage . . . .<sup>65</sup>

The Florida District Court of Appeal, Third District, has also applied the "exception" in a case in which the complaint apparently negated coverage, but instead contained a mistaken allegation. In *Tropical Park, Inc. v. United States Fidelity & Guaranty Co.*,<sup>66</sup> the insured sued its insurer to recover costs incurred in the insured's defense of a third party's complaint. The plaintiff, Mr. Perez, claimed that he was injured while exercising a horse on the insured's track. Perez alleged that he was a "free-lance jockey." Based on that allegation, the insurer refused to defend because an exclusionary provision in the insured's policy denied coverage for injuries to jockeys.<sup>67</sup> At trial it was established that the plaintiff was not a "free-lance jockey," as alleged, but rather an exercise boy hired the day of the accident to gallop the horse.<sup>68</sup>

The issue before the court in *Tropical Park* was whether a duty to defend existed when the complaint was ambiguous as to the applicability of an exclusion, but the actual facts triggered coverage.<sup>69</sup> The court ostensibly relied on the exclusive pleading test,<sup>70</sup>

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65. *Id.* at 930. *But cf.* *Mol v. Holt*, 86 Ill. App. 3d 838, 409 N.E.2d 20 (1980). In *Holt* the plaintiffs sued the insured for injuries sustained in an automobile collision. The family insurance policy covered a Volkswagen and "additional owned vehicles," but required the insured to notify the insurer of the purchase of any new automobiles. The complaint alleged that the insured's car involved in the collision was a Camaro. The insurer declined defense on the ground that the insured had not notified it of his ownership of the Camaro, thereby breaching a condition of the policy. The court held that the insurer had breached its obligation to defend, notwithstanding the actual fact that the car was not covered, because the complaint did not clearly allege facts which, if true, would exclude coverage. Thus, since there was a "potentiality" of coverage, the duty to defend existed. *Id.* at 840-41, 409 N.E.2d at 23; *see also infra* note 195.

66. 357 So. 2d 253 (Fla. 3d DCA 1978).

67. The provision excluded injuries to "any person while practicing for, or participating in any contest, exhibition of an athletic or sports nature sponsored by the insured . . ." *Id.* at 255.

68. *Id.* at 256.

69. *Cf.* *Capoferri v. Allstate Ins. Co.*, 322 So. 2d 625 (Fla. 3d DCA 1975) (rejecting the insured's argument that an insurer cannot deny the existence of a duty to defend based on bare allegations of an excluded event when the insurer's own investigation shows that the allegations are groundless). *See supra* note 11 and accompanying text for a discussion of the insurer's duty to defend regardless of its ultimate duty to indemnify.

70. "The original complaint . . . must allege facts which fairly bring the cause within the coverage of the insurance contract even though ultimately there is no liability." 357 So. 2d at 256 (emphasis added).

but found that the policy exclusion did not apply<sup>71</sup> because the actual facts showed that the plaintiff was an exercise boy, not a jockey.<sup>72</sup> The court reasoned that "the mistaken allegation in the complaint that the claimant was a 'free-lance jockey' as opposed to an exercise boy cannot *reasonably* be interpreted as placing the claim within the exclusionary clause."<sup>73</sup>

*Lamb Brothers, Rowell, and Tropical Park* suggest that when the insurer is relying on an exclusionary clause to avoid a duty to defend, and the allegations of the complaint are ambiguous or patently false,<sup>74</sup> the court may consider the actual facts, rather than the pleadings, to determine coverage. The United States District Court for the Northern District of Georgia, however, applying Florida law, extended the exception to a complaint that on its face activated a policy exclusion, but also contained conclusory allegations unsupported by the facts.

This extension of the exception occurred in *Old Hickory Prod-*

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71. The court's reasoning on this point was rather interesting, if not fallacious. As an initial premise, the court observed that the complaint alleged that the plaintiff was injured while exercising a horse. Because the allegations did not contain the words used in the exclusionary clause, "participating in" or "practicing for," the allegation of "exercising a horse" did not activate the exclusion. One could argue, however, that when a jockey *exercises* a horse, that person may also be *practicing* for a race. The two terms do not appear to be mutually exclusive, until one adds the term "jockey" or "exercise boy." Thus, if a jockey is exercising a horse, one may also consider him to be practicing for a race. If an exercise boy is on the horse, however, then he is not practicing for a race. The key to the validity of the court's first premise, then, depends on its second premise regarding the identity of the rider.

In *Tropical Park* the court completely discarded the *alleged* identity of the rider as a free-lance jockey and made its finding based on the fact that he was an exercise boy. This finding, of course, is inconsistent with the exclusive pleading test. The court's conclusion, then, although quite just, is based on two invalid premises and therefore is unsound.

72. See also *Cotton States Mut. Ins. Co. v. Jacob*, 379 So. 2d 129 (Fla. 3d DCA 1979).

73. 357 So. 2d at 257 (emphasis added). The holding in *Tropical Park* is not consistent with the holding in *Capoferri v. Allstate Ins. Co.*, 322 So. 2d 625 (Fla. 3d DCA 1975). In both cases the issue was whether an insurer may refuse to defend based on the bare allegations of an event that would exclude coverage. The allegations in both cases were demonstrably false or groundless. In *Capoferri* the court held that an insurer need not defend, presumably deriving its conclusion from a negative implication of the standard language: The insurer will defend any suit alleging facts within coverage even if any of the allegations are groundless, false, or fraudulent. Thus, the negative implication produces the principle that the insurer need not defend any suit alleging facts within or an exclusion, even if the allegations are groundless, false, or fraudulent. In *Tropical Park* the allegations of the exclusion were "mistaken," i.e., false. Yet the court held that the insurer had a duty to defend.

74. See *Burton v. State Farm Mut. Auto Ins. Co.*, 335 F.2d 317 (5th Cir. 1964) (applying Florida law). In dicta the court said, "knowledge by the Insurer that the wrong party has been sued is not different from knowledge that the liability facts are different than alleged in the third-party suits. Yet clearly in the latter instance the duty to defend is positive." *Id.* at 323.

*ucts Co. v. Hickory Specialists, Inc.*<sup>75</sup> An insured instituted a third-party action in a federal court against its insurer when the latter refused to defend a suit that alleged several causes of action,<sup>76</sup> because every count contained allegations of intentional acts.<sup>77</sup> The insurer's refusal was based on an exclusionary clause presumably<sup>78</sup> denying coverage for intentional acts. After concluding that Florida law applied,<sup>79</sup> the United States District Court for the Northern District of Georgia decided that it could not determine the insurer's duty to defend from the allegations in the complaint. While the court recognized the "basic rule" in Florida, it did not apply that rule because "[t]he allegation of bad faith and wilfulness in connection with [the insured's] alleged deceptive advertising is wholly conclusory and unsupported by specific factual allegations in the complaint."<sup>80</sup>

In rejecting the exclusive pleading test, the court maintained that the rule originated from cases involving complaints<sup>81</sup> that detailed the facts relating to the duty to defend.<sup>82</sup> The rule lost its efficacy, however, with the advent of notice pleading in federal courts. In addition, the court observed that the rule in Florida was not absolute.<sup>83</sup> Thus, on remand the existence of the insurer's duty

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75. 366 F. Supp. 913 (N.D. Ga. 1973).

76. The causes of action included wrongful appropriation of trade secrets, interference with contractual relations with an employee, and of particular relevance to the issue of the duty to defend, unfair advertising and marketing. *Id.* at 914.

77. *Id.* at 923. "All of the foregoing acts of defendants have been and continue to be committed wilfully, deliberately and in bad faith."

78. The court did not quote the language of the policy.

79. There was no question that Florida law governed the construction of the contract, but the parties disagreed over whether the district court, sitting in Georgia, should apply the duty to defend under Florida law, or under the Georgia state courts' likely interpretation of Florida law. *Id.* at 914-15. This issue seemed to be crucial because under Georgia law the insurer had a duty to defend regardless of the pleaded allegations when the true facts known to, or reasonably ascertainable by, the insurer afforded coverage. See *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962). Florida law, however, followed the exclusive pleading test, which states that the allegations of the complaint alone govern the duty to defend.

80. 366 F. Supp. at 923.

81. Indeed, many argue that the test is anachronistic because it evolved under code pleading, which required a detailed statement of the facts in the complaint to support the cause of action. Under the present system of notice pleading, however, the complaint merely serves a notice function, and with liberal rules of amendment, one cannot accurately predict the nature of the plaintiff's recovery. See *Babcock & Wilcox Co. v. Parsons Corp.*, 430 F.2d 531 (8th Cir. 1970).

82. See, e.g., *Bennett v. Fidelity & Casualty Co.*, 132 So. 2d 788, 789 (Fla. 1st DCA 1961).

83. *Tennessee Corp. v. Lamb Bros. Constr. Co.*, 265 So. 2d 533 (Fla. 2d DCA 1972); see *supra* notes 57-73 and accompanying text.

to defend would depend on whether the actual facts showed coverage or an exclusion.<sup>84</sup>

D. *The Exclusive Pleading Test: Is It the Sole Measure in Florida?*

Interestingly, in *Hickory* the federal district court predicted that the Supreme Court of Florida would examine the objective facts of the suit to determine whether coverage, and consequently a duty to defend, existed.<sup>85</sup> The court's prediction, however, may have been incorrect. In *National Union Fire Insurance Co. v. Lenox Liquors, Inc.*,<sup>86</sup> the Supreme Court of Florida apparently<sup>87</sup> reaffirmed Florida's adherence to the exclusive pleading test as the sole method for determining a duty to defend. The Lenox liquor store carried a standard liability policy covering injuries caused by an "occurrence," defined as an accident resulting in injury that the insured neither expected nor intended.<sup>88</sup>

In *Lenox* two boys who were carrying BB and pellet guns entered the insured store. Rosen, the president of Lenox Liquors, thought the youngsters were robbing the store and shot one of them. The injured boy sued Lenox and Rosen, alleging that Rosen

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In *St. Paul Fire & Marine Ins. Co. v. Icard, Merrill, Cullis & Timm, P.A.*, 196 So. 2d 219 (Fla. 2d DCA 1967), the insurer refused to defend a suit that a disgruntled client brought against the insured law firm. The plaintiff wrote and signed the underlying complaint. It contained unsupported conclusory allegations and accusations directed not only against the firm and its members, but also against the entire Sarasota bar. The plaintiff alleged several "theories," including conspiracy, but averred no supporting facts. The insured presented the complaint to the insurer, who declined to defend because the policy excluded "dishonest, fraudulent, criminal, or malicious" acts or omissions. The court held that the insurer had unjustifiably relied on the complaint because it was "grossly insufficient in its averment of facts, as distinguished from conclusions . . ." *Id.* at 222.

The *Hickory* court's reliance on *St. Paul* for the principle that the actual facts controlled the duty to defend seems erroneous. The basis for the court's holding in *St. Paul* was not that the true facts indicated coverage; rather it was that the complaint contained allegations partially within and outside coverage. *Id.* at 222-23; see *supra* note 39; see also *Employers Commercial Union Ins. Co. of Am. v. Kottmeier*, 323 So. 2d 605 (Fla. 2d DCA 1975). In any event, *St. Paul* is of dubious precedential value in light of its unusual facts. Indeed, the Fifth Circuit has recently stated that *St. Paul* should be confined to instances of "home-drawn, *pro se*" complaints. *ABC Distrib., Inc. v. Lumbersmens Mut. Ins. Co.*, 646 F.2d 207, 209 (5th Cir. 1981).

84. The policy covered injuries caused by an "occurrence," defined as an accident "neither expected nor intended by the insured." 366 F. Supp. at 923 (emphasis added). The question at trial, then, would be whether the insured "expected" or "intended" the alleged wrongful conduct.

85. 366 F. Supp. at 924.

86. 358 So. 2d 533 (Fla. 1977).

87. See *infra* notes 95-101 and accompanying text.

88. See *supra* note 1 and accompanying text.

"assaulted him by maliciously, willfully and wantonly firing a loaded shotgun at him striking him in the back, thereby causing grievous personal injury."<sup>89</sup> When the insurer refused to defend, the insured filed a third-party complaint demanding indemnification for any adverse judgment. The trial court granted the insurer's motion to dismiss on the ground that the allegation of an intentional injury obviated the insurer's duty to defend.<sup>90</sup>

The plaintiff and Lenox settled the underlying action and stipulated that if they had tried the case, the plaintiff would have proceeded on the theory that the insured's conduct was negligent, not willful.<sup>91</sup> On the basis of this stipulation, the insured instituted an action to recover its costs of settlement and defense. The trial court found that the claim fell within the "exception" to the exclusive pleading test<sup>92</sup> because Rosen had acted unintentionally. The District Court of Appeal, Third District, affirmed based on the insurer's participation in the stipulation.<sup>93</sup>

In a terse opinion the Supreme Court of Florida applied the exclusive pleading test<sup>94</sup> and found that since the complaint alleged an intentional act, no coverage and therefore no duty to defend could exist. The question that immediately arises is whether the court's holding means that in Florida the sole determinant of the duty to defend is now the exclusive pleading test, or whether under the unique facts of the case, the "exception" simply had no application.

In *Federal Insurance Co. v. Applestein*,<sup>95</sup> the District Court of Appeal, Third District, inferred a broad holding from *Lenox* and

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89. 358 So. 2d at 533.

90. The judgment was without prejudice to the insured to amend its third-party complaint if the plaintiff filed a subsequent action in which a covered event was alleged. *Id.* at 534.

91. *Id.*

92. See *supra* notes 57-84 and accompanying text. The Supreme Court of Florida defined the exception to the rule as follows: "[A]n insurer is obligated to defend its insured when the insurer knows or should reasonably be expected to know the facts which bring the claim within the purview of the policy." 358 So. 2d at 534.

93. The Third District used this finding to distinguish *Capoferri v. Allstate Ins. Co.*, 322 So. 2d 625 (Fla. 3d DCA 1975), which also involved a complaint that on its face excluded coverage. See *supra* notes 51-56 and accompanying text. The Supreme Court of Florida rejected the distinction, because the insurer in *Lenox* merely had recited in the stipulation that the *other parties* had agreed to the negligence theory. The insurer had not participated. Thus, the court accepted certiorari because of the conflict between *Lenox* and *Capoferri*. 358 So. 2d at 535.

94. "The allegations of the complaint govern the duty of the insurer to defend." *Id.* at 536. By implication the stipulation was immaterial.

95. 377 So. 2d 229 (Fla. 3d DCA 1979), *cert. denied*, 389 So. 2d 1107 (Fla. 1980).

interpreted the decision to mandate the rejection of the exception in favor of the exclusive pleading test.<sup>96</sup> Because of the dubious rationale employed in *Applestein*<sup>97</sup> and the *Lenox* court's failure

96. The "decision necessarily involves the supreme court's endorsement of the opposite view that 'allegations, rather than known or ascertainable facts, determine [the] insurer's duty to defend.'" *Id.* at 233 n.3. In *Applestein* the plaintiff brought suit against the insureds, Mr. Applestein and the Applestein Foundation Trust. The plaintiff's fourth amended complaint alleged libel, slander, and intentional infliction of emotional distress; each allegation stated that the insured had acted with malice, bad faith, and reckless disregard for the plaintiff's rights. The complaint also alleged that the foundation had ratified and approved Applestein's acts.

Although the policy covered libel and slander, it excluded intentional acts; accordingly, the insurer refused to defend. In the action for a declaratory judgment, the insured argued that the actual facts elicited through discovery revealed that Applestein was not a "managing trustee" of the foundation and the foundation had not ratified or approved his acts. Therefore, the liability of the insured was indeed covered. The court's reply was succinct: "We need not consider whether this argument represents an accurate view of the record, because the legal proposition upon which it is based is unsound." *Id.* at 232. After stating what it believed to be the rule in *Lenox*, the *Applestein* court concluded: "Thus, the 'actual facts' of the situation are not pertinent to the issues involved in the case before us." *Id.* at 233.

97. The *Applestein* court held that because the allegations of the complaint did not trigger a duty to defend, the duty to indemnify did not exist either, notwithstanding that the actual facts might have indicated coverage. The court's rationale was based on the axiom that the duty to defend is broader than the duty to pay. Thus, when no duty to defend arose from the allegations of the complaint, *a fortiori*, no duty to indemnify existed either.

Evidently, the court erred, however, because its conclusion stems from a non sequitur. The duty to defend is considered to be distinct from, and broader than, the duty to pay. The duty to defend is based on the allegations of the complaint, which may be either true or false; the duty to pay is narrower because it always depends on the true facts established at trial. *See, e.g., Aetna Ins. Co. v. Waco Scaffold & Shoring Co.*, 370 So. 2d 1149, 1151 (Fla. 4th DCA 1978) ("[T]he fact that appellants had a duty to defend under these circumstances does not necessarily mean that they were obligated to pay any judgment recovered. *That question is determined by the facts established at trial.*" (emphasis added)); *see also supra* note 3.

The standard insurance policy language belies the *Applestein* court's conclusion. A standard policy reads: "The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of

- A. bodily injury or
- B. property damages

to which this insurance applies, caused by an occurrence . . . ." 7C J. APPLEMAN, *supra* note 2, § 4682, at 22 n.9 (emphasis added). Manifestly, the insured does not become legally obligated to pay from the mere allegations in the injured party's complaint, but rather becomes obligated to pay only after trial and an adverse final judgment. Moreover, the language "to which this insurance applies" necessarily involves a determination based on the actual facts established at trial. Thus, with reference to the duty to pay, neither the insured nor the insurer is subject to the vagaries of a third-party complaint over which they have no control.

As the Fifth Circuit, applying Texas law in *Green v. Aetna Ins. Co.*, 349 F.2d 919 (5th Cir. 1965), explained:

In articulating [the] standard for determining the duty to defend, Justice Hamilton distinguishes the liability [between the duty to indemnify and defend clauses]. With respect to payment of the claim, . . . the Court pointed out the



to explicitly address the conflicting rules, one can argue that the *Lenox* court merely decided that the exception did not apply to the particular circumstances of the case.

The "exception" to the exclusive pleading test is more accurately a "factual test" that requires the insurer to defend when the alleged facts exclude coverage, but the unpleaded true facts known to the insurer are within coverage.<sup>98</sup> Thus, the exception necessarily implies a variance between the false alleged facts and the unpleaded true facts. Without this variance, the exception does not apply. The hiatus in the *Applestein* court's reasoning is that in *Lenox* there were no "actual facts" diverging from those alleged in the complaint. The supreme court specifically reviewed the stipulation between the plaintiff and the insured and found that the settlement was only between the parties to the principal action. Although the insurer acknowledged the settlement, the acknowledgment did not bind the insurer.<sup>99</sup> In essence, the court properly held<sup>100</sup> that because the insurer did not participate in the

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"insurer does not pay because [the assured] is alleged to be legally responsible but because [the assured] has been adjudicated to be legally responsible." 387 S.W.2d at 25. (Emphasis supplied). The Court highlights the contrast when it goes on to state: "The coverage in [the duty to defend clause] is entirely different from the coverage in [the duty to indemnify clause]. No legal determination of ultimate liability is required before the insurer becomes obligated to defend the suit. That paragraph has reference to a suit seeking to recover damages that are covered in [the duty to indemnify clause]. \* \* \* The coverage in [the duty to defend clause] does not depend on what the facts are or what might finally be determined to be the facts. It depends only on what the facts are alleged to be. To put it simply, [the duty to indemnify clause] protects all [assureds] from payment of damages they may be found legally obligated to pay under [that clause]. [The duty to defend clause] protects the same parties against the expense of any suit seeking damages under [the duty to indemnify clause]." 387 S.W.2d at 25.

*Id.* at 924 (some brackets in original, some added).

Thus, contrary to the *Applestein* court's conclusion, the duty to defend is distinct from the duty to indemnify. A determination from the complaint that there is no duty to defend does not automatically lead to "the inevitable conclusion that there is [no duty to indemnify against] an eventual judgment which may be entered upon that claim." 377 So. 2d at 233.

98. See *supra* note 92.

99. 358 So. 2d at 535. *But cf.* *Shepard Maine Constr. Co. v. Maryland Casualty Co.*, 73 Mich. App. 62, 250 N.W.2d 541 (1976) (insurer who participated in stipulation which brought claim within coverage had duty to defend, notwithstanding third-party complaint's allegation of a completed operations exclusion).

100. The holding of the court was not only technically sound, but was also supported by strong policy considerations. If the court had given effect to the stipulation, the decision would promote collusion between plaintiffs and insureds. The case certainly did not present the court with the "right" or "best" factual setting in which to apply the exception. *But see infra* notes 125-56 and accompanying text.

Commentators have criticized the decision: "The insured believed he was properly de-

agreement, and the parties did not proceed to trial, the "actual facts" were never established. Accordingly, without any proof of actual facts that conflicted with the complaint's allegations, the exception could not apply. If this reasoning is correct, then the factual test is still available in Florida. If, however, the *Applestein* court's interpretation is correct, then the question remains whether cases such as *Hickory* and *Lamb Brothers* are impliedly overturned.<sup>101</sup>

#### V. AN "EXCEPTION" BECOMES A RULE: THE FACTUAL TEST

Courts that have deviated from the exclusive pleading test advance various reasons for adopting the "factual test."<sup>102</sup> First, with the advent of notice pleading in federal<sup>103</sup> and state courts,<sup>104</sup> the complaint may not contain sufficient facts to enable an insurer to determine accurately whether a duty to defend exists.<sup>105</sup> Under the present pleading system, the complaint merely serves a notice function, without truly informing the defendant of the nature or extent of the plaintiff's claims.<sup>106</sup> Moreover, with the liberal rules of amendment<sup>107</sup> and the toleration of variances between the evi-

fending himself. The insurer knew or should have known this. Both a duty to defend and a duty to indemnify should have been found." 7C J. APPLEMAN, *supra* note 2, § 4685.01, at 20 n.15 (Supp. 1981).

101. *Hickory* must eventually be rejected because the complaint in that case alleged an excluded event, as did the complaint in *Lenox Lamb Bros.* is more questionable because it could be distinguished on the ground that the complaint did not indicate whether the exclusion applied or not.

102. These reasons will be developed in more detail, *infra* notes 103-14 and accompanying text.

103. FED. R. CIV. P. 8(a): "A pleading which sets forth a claim for relief . . . shall contain . . . (2) a short and plain statement of the claim showing that the pleader is entitled to relief . . ."

104. Florida courts have adopted notice pleading. C.A. Fielland v. Fidelity & Casualty Co., 297 So. 2d 122 (Fla. 2d DCA 1974), *cert. denied*, 309 So. 2d 6 (Fla. 1975).

105. *See, e.g.,* Ross Island Sand & Gravel Co. v. General Ins. Co., 472 F.2d 750 (9th Cir. 1973).

106. [P]laintiffs frequently elect to assert their claims in broad, general terms. The parties then resort to interrogatories, requests for admissions, and the like, to flesh out pretrial orders that will provide the trier of fact a simple statement of the issues of law and fact remaining to be resolved in court. In such a pleading environment, a complaint may or may not provide an insurance carrier with enough information to permit an informed judgment on whether or not he must defend.

*Id.* at 752.

107. FED. R. CIV. P. 15(a) states in part:

A party may amend his pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar,

dence and the theory that the plaintiff posits, one can hardly consider the complaint as an accurate indication of the basis of the plaintiff's ultimate claims. In this pleading environment, then, reference to the complaint alone may lead to harsh and inequitable results.

The second justification for adopting the factual test is the plaintiff's propensity for overstating his claims. Even if an injury results from negligence, a plaintiff may allege only an intentional tort in order to support an award of punitive damages or increase his chances of a favorable settlement. Since most, if not all, insurance policies exclude coverage for intentional torts, insured parties may be denied legal representation when in fact the claim is adjudicated to be within the policy coverage.

A third justification, closely related to the second, centers on the insured's reasonable expectations.<sup>108</sup> If the insured were to state his belief as to what the duty to defend provision meant, he would probably express an expectation that his insurer would defend him whenever the complaint suggests the possibility of liability based on facts within the policy's coverage.<sup>109</sup> Hence, if the insured were sued for intentional assault and battery, which the policy did not cover, and the insured had acted in self-defense, the insured would reasonably expect the insurer to defend.<sup>110</sup>

The courts that consider the insured's reasonable expectations often view the insurance policy as an adhesion contract. Most of the provisions of the policy—especially the duty to defend

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he may so amend it at any time within 20 days after it is served. Otherwise a party may amend his pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires.

108. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); Comment, *supra* note 13.

109. Comment, *supra* note 13, at 748. The author argues persuasively that:

The insured probably would be surprised at the suggestion that defense coverage might turn on the pleading rules of the court that a third party chose or on how the third party's attorney decided to write the complaint. In some cases the insured might think in terms of his own conduct. The bar owner, for example, might well think that he is insulated from any legal expense arising from injuries to patrons so long as he personally does not intentionally injure someone or tell an employee to do so. To him the possibility of an ambitious claimant who would begin a lawsuit with a charge of intentional injury for the sake of a favorable bargaining position and later be willing to abandon that charge for one of simple negligence might not occur; or if the possibility did occur the insured might not pause to consider whether it would be fatal to part of his insurance coverage.

*Id.*

110. *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

clause—are standardized and not subject to meaningful negotiation. The insured accepts the policy “as is,” and has no real opportunity to bargain with another insurance company for more favorable terms. Even if the duty to defend clause were subject to negotiation,<sup>111</sup> most negotiations would not benefit the insured because the parties probably could not agree on the appropriate test to be applied in disparate factual settings. Therefore, because of this adhesion contract setting, many courts tend to construe the policy’s provisions narrowly.

Closely related to an adhesion analysis is the contract principle of *contra proferentem*, under which ambiguous provisions in an insurance policy are construed most strongly against the party who selected the language—the insurer.<sup>112</sup> This principle is most often employed in rejecting an exclusion that the court finds ambiguous.<sup>113</sup> Since the court can apply the principle only when it finds an ambiguous provision, however, the principle has a more narrow scope than the adhesion contract analysis.<sup>114</sup>

## VI. THE ANALYTICAL FRAMEWORK: THE TWO TESTS AS APPLIED

All of the above justifications favor the application of the factual test in determining whether a duty to defend exists. There are, of course, countervailing considerations which support the traditional rule, and which the factual test cannot supply: efficiency, ease of application, and objectivity. Neither rule alone is the complete panacea for both insureds and insurers. Rather, the respective tests become appropriate or inappropriate depending on the factual setting in which they are applied.

There are at least six conceptually distinct fact patterns<sup>115</sup> that may arise in establishing the duty to defend.<sup>116</sup> It is necessary

111. To a layman, and even perhaps to an attorney unfamiliar with insurance practice, the duty to defend clause appears rather innocuous. Yet, the extensive litigation over the meaning of the clause belies the appearance of simplicity. See Comment, *supra* note 13, at 734.

112. See, e.g., *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949).

113. See, e.g., *Lowell v. Maryland Casualty Co.*, 65 Cal. 2d 298, 419 P.2d 180, 54 Cal. Rptr. 116 (1966).

114. See Note, *Liability Insurer's Duty to Defend: American Policyholders' Ins. Co. v. Cumberland Cold Storage Co.*, 30 ME. L. REV. 295, 302 (1979).

115. For purposes of analysis, this author has omitted the factual possibility that a complaint may contain facts partially within and partially outside coverage. Almost all jurisdictions agree that when a defendant tenders this type of complaint, the insurer must defend the entire suit, at least until the parties narrow the claim to a noncovered event. See *supra* note 39.

116. See Dahoney, *supra* note 13, at 456. The author identifies four categories of alleg-

to examine each fact pattern to determine which test is more appropriate under the circumstances. These patterns are:

- (1) The allegations of the complaint and the extraneous facts indicate coverage under the applicable policy provisions.
- (2) The allegations of the complaint indicate the applicability of an intentional injury exclusionary provision.
- (3) The allegations against the insured are unclear, conclusory, or ambiguous as to coverage; the unpleaded actual facts indicate, or are compatible with coverage.
- (4) The allegations are unclear, conclusory, or ambiguous as to coverage; the unpleaded actual facts indicate noncoverage or the applicability of an exclusion.
- (5) The allegations and the actual facts conflict. The allegations indicate a policy exclusion; the actual facts indicate coverage or a potential for coverage.
- (6) The allegations and the actual facts conflict. The allegations trigger coverage; the actual facts activate an exclusion or show noncoverage.

A. SITUATION 1: *The allegations of the complaint and the extraneous facts indicate coverage under the applicable policy provisions.*

The first factual setting presents the strongest case for the application of the exclusive pleading test. In this situation courts uniformly hold that if the complaint indicates coverage, the insurer must defend,<sup>117</sup> irrespective of the veracity of the allegations. The only difference among the various courts involves the standard of interpretation used when the pleadings are compared to the cover-

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tions that have posed problems for the judiciary and suggests how courts would resolve each one under Texas law. The four categories include: (1) a complaint containing allegations clearly within or clearly outside coverage; (2) a complaint containing allegations partially within and partially without coverage; (3) a complaint containing ambiguous or general allegations; (4) a complaint containing allegations that conflict with the known or ascertainable facts.

In identifying these categories, the author does not distinguish between a complaint with conclusory allegations in which the unpleaded actual facts indicate coverage and one with conclusory allegations in which the unpleaded actual facts indicate noncoverage or an exclusion. Similarly, the author fails to distinguish between a complaint containing a variance between the actual and alleged facts when the actual facts indicate coverage and one containing a variance between the actual and alleged facts when the actual facts indicate an exclusion. As this article points out, *infra*, many courts will distinguish between these categories of allegations in applying different tests for determining the obligation to defend.

117. Courts under this factual setting apply the "comparison test," matching the complaint with the policy provisions to ascertain whether the claimed injury is within the policy's coverage. See *supra* note 24 and accompanying text.

age provisions of the insurance policy. Thus, if the complaint contains facts which fairly,<sup>118</sup> arguably,<sup>119</sup> or potentially<sup>120</sup> fall within the policy's coverage, the insurer must defend.<sup>121</sup>

The exclusive pleading test is applied in this factual setting because of the language of the insurance policy: "[T]he company shall defend any suit alleging [a covered risk] and seeking damages which are payable under the terms of this policy, even if any of the allegations of the suit are groundless, false or fraudulent . . . ."<sup>122</sup> Under the first factual setting, the insurer must defend because it has expressly obligated itself to defend against *alleged* covered risks, even if groundless, false, or fraudulent. Thus, because the contractual language of the obligation to defend explicitly covers the first factual setting, the contract is dispositive of the rights of the parties.<sup>123</sup> This conclusion, that the exclusive pleading test applies when the complaint and facts both trigger coverage, is well-settled in American jurisprudence.<sup>124</sup>

118. See, e.g., *Accredited Bond Agencies, Inc. v. Gulf Ins. Co.*, 352 So. 2d 1252, 1253 (Fla. 1st DCA 1977).

119. See, e.g., *Carolina Aircraft Corp. v. American Mut. Liab. Ins. Co.*, 517 F.2d 1076, 1077 (5th Cir. 1975) (applying Florida law).

120. See, e.g., *Travelers Indem. Co. v. Dingwell*, 414 A.2d 220 (Me. 1980):

Whether [the insured] can obtain a defense from his insurer must depend not on the caprice of the plaintiff's draftmanship, nor the limits of his knowledge, but on a *potential* shown in the complaint that the facts ultimately proved may come within the coverage. Even a complaint which is legally insufficient to withstand a motion to dismiss gives rise to a duty to defend if it shows an intent to state a claim within the insurance coverage.

*Id.* at 226 (emphasis in original).

121. Although at first glance these three standards appear similar, their use can actually lead to quite disparate results. Generally, "potential" coverage is broader than "fairly within coverage." The use of "arguably" or "potentially" can result in an otherwise excluded event being considered within coverage. For instance, some courts when confronted with a complaint alleging an intentional tort will hold that the excluded event is "arguably" or "potentially" within coverage, because the injured party may only succeed in proving a negligent (as opposed to intentional) act. See, e.g., *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966). It appears that such a broad construction of the plaintiff's complaint will trigger a duty to defend whenever the alleged event is excluded, rendering nugatory the effect of exclusionary provisions. One commentator has aptly characterized this approach as making the insurer's duty to defend absolute. See Note, *The Insurer's Duty to Defend Made Absolute: Gray v. Zurich*, 14 U.C.L.A. L. Rv. 1328 (1967). See generally *infra* notes 130-44 and accompanying text.

122. See *supra* note 9 and accompanying text.

123. Significantly, the language of the contract is dispositive only under the first and sixth factual settings. The language only purports to cover a situation in which the allegations trigger coverage.

124. See, e.g., *Shaw v. Aetna Casualty & Sur. Co.*, 407 F.2d 813 (7th Cir. 1969) (interpreting Illinois law); *Green v. Aetna Ins. Co.*, 349 F.2d 919 (5th Cir. 1965) (applying Texas law); *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949) (dictum); *Oliver B.*

**B. SITUATION 2: *The allegations of the complaint indicate the applicability of an intentional injury exclusionary provision.*<sup>125</sup>  
*Is there an automatic duty to defend?***

When the complaint against the insured alleges an intentional injury that is expressly excluded from coverage under the policy, one would expect that a duty to defend could not arise. Presumably, the coverage provisions of the policy circumscribe the duty to defend. Yet, a growing minority of courts hold either that the allegation of an intentional injury suffices to trigger a duty to defend, or the allegations do not conclusively determine whether a duty to defend exists.<sup>126</sup>

The courts which hold that the mere allegation of an excluded or noncovered event precludes an insurer's duty to defend base their conclusion on the exclusive pleading test, with many relying on the policy's language: The company will defend any suit alleging a covered event, even if the allegations are groundless, false, or fraudulent.<sup>127</sup> This clause, however, is couched in positive terms and explicitly covers a situation in which the allegations include facts within coverage. The courts that rely on the exclusive pleading test when the allegations indicate a policy exclusion or noncoverage predicate their position on a negative implication of the positive policy language regarding the duty to defend the insured.<sup>128</sup>

Cannon & Son v. Fidelity & Casualty Co., 484 F. Supp. 1375 (D. Del. 1980) (applying Pennsylvania law); Travelers Indem. Co. v. Dingwell, 414 A.2d 220 (Me. 1980); Atcheson v. Safeco Ins. Co., 165 Mont. 239, 527 P.2d 549 (1974); Hastings v. Royal-Globe Ins. Co., 521 S.W.2d 869 (Tex. Civ. App. 1975). See generally Annot., 50 A.L.R.2d 458 (1956).

125. An example of an intentional injury exclusion is a claim of assault and battery.

126. For a further discussion of these cases, see *infra* text accompanying notes 147-51, 155-56.

127. See, e.g., Carolina Aircraft Corp. v. American Mut. Liab. Ins. Co., 517 F.2d 1076 (5th Cir. 1975) (applying Florida law); Scherschlight v. Empire Fire & Marine Ins. Co., 494 F. Supp. 936 (S.D.S.D. 1980) (applying Nebraska law); Ladner & Co. v. Southern Guar. Ins. Co., 347 So. 2d 100 (Ala. 1977); Pauline v. Fireman's Fund Ins. Co., 1 Ariz. App. 408, 403 P.2d 555 (1965); Kylo v. Northland Chem. Co., 209 N.W.2d 629 (N.D. 1973); Isenhardt v. General Casualty Co. of Am., 233 Or. 49, 377 P.2d 26 (1962); McDonald v. United Pac. Ins. Co., 210 Or. 895, 311 P.2d 425 (1957); Amundsen v. Great Cent. Ins. Co., 451 S.W.2d 277 (Tex. Civ. App. 1970); Travelers Ins. Co. v. Newson, 352 S.W.2d 888 (Tex. Civ. App. 1961) (finding that no duty existed based on allegations of assault and battery, even though no assault took place).

128. See *supra* notes 54 & 73 and accompanying text.

Although this principle is usually invoked to compel an insurance company to defend an action in which the allegations of the complaint bring it within the coverage of the policy, regardless of the ultimate outcome of the action or the liability of the insured, yet, there is no logical reason not to apply it conversely; that is, in those cases in which the allegations of the complaint do not bring the action within the coverage of the policy.

Some recent decisions question whether the application of the exclusive pleading test is warranted when the complaint seemingly excludes coverage but the allegations are either groundless or overstated.<sup>129</sup> The majority of these cases reject the argument that because the contract obligates an insurer to defend an alleged covered risk, therefore, the converse proposition that the insurer need not defend an alleged noncovered or excluded risk must be true. Although this argument follows logically, courts have evaded it under a number of different theories.

One of the most persuasive and comprehensive opinions representing the trend of authority is that of the Supreme Court of California in *Gray v. Zurich Insurance Co.*<sup>130</sup> Dr. Gray, the insured, sued his insurer to recover costs incurred in defending a lawsuit that alleged he had committed an assault.<sup>131</sup> The insurer refused to defend the suit because of an exclusionary provision in the policy denying coverage for injuries "caused intentionally by or at the direction of the insured."<sup>132</sup> Gray, however, claimed that he had acted in self-defense. At trial his defense was unavailing.<sup>133</sup> The issue in the subsequent action against the insurer was whether the insurer had a duty to defend a complaint against its insured that alleged an excluded intentional injury.<sup>134</sup>

The court held that the insurer had a duty to defend on alter-

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Allstate Ins. Co. v. Coriell, 30 Ohio Misc. 67, 72-73, 284 N.E.2d 202, 206 (C.P. Scioto County 1971).

129. *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178 (7th Cir. 1980); *Lowell v. Maryland Casualty Co.*, 65 Cal. 2d 298, 419 P.2d 180, 54 Cal. Rptr. 116 (1966); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *Firco, Inc. v. Fireman's Fund Ins. Co.*, 173 Cal. App. 2d 524, 343 P.2d 311 (1959); *Raday v. Board of Educ.*, 130 N.J. Super. 552, 328 A.2d 17 (App. Div. 1974). *Contra St. Paul Ins. Co. v. Talladega Nursing Home*, 606 F.2d 631 (5th Cir. 1980) (applying Alabama law, court concluded that insurer had no duty to defend complaint alleging series of intentional injury exclusions, despite insured's claim that allegations were groundless and overstated); *Allstate Ins. Co. v. Coriell*, 30 Ohio Misc. 67, 284 N.E.2d 202 (C.P. Scioto County 1971); *Angelone v. Union Mut. Ins. Co.*, 113 R.I. 230, 319 A.2d 344 (1974); *Brisco v. Travelers Indem. Co.*, 18 Wash. App. 662, 571 P.2d 226 (1977).

130. 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966).

131. The incident which gave rise to the underlying suit was as follows: The insured driver, Dr. Gray, narrowly missed colliding with another car. The other driver, Jones, approached Gray in a menacing manner and jerked the car door open. Gray, fearing personal injury, ended the altercation by punching Jones. *Id.* at 267 n.1, 419 P.2d at 170 n.1, 54 Cal. Rptr. at 106 n.1.

132. *Id.* at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106.

133. The judgment awarded Jones \$61,000 actual damages, but did not award punitive damages.

134. Significantly, the actual facts did not diverge from the alleged facts. For a discussion of this fact situation, see *infra* text accompanying notes 197-264.



native grounds.<sup>135</sup> First, the court found the duty to defend under the policy to be a primary duty, and the exclusionary provision under which the insurer sought to avoid the duty unclear and inconspicuous.<sup>136</sup> Since the insured reasonably expected his insurer to defend this type of suit, the insurer had a duty to defend.<sup>137</sup> The court suggested that the exclusionary provision was ambiguous because the policy could still cover intentional acts resulting in unintended harm.<sup>138</sup>

As an alternative ground for its holding on the insurer's duty to defend, the court accepted, for purposes of argument, the insurer's premise that the third-party complaint should define the insurer's duty to defend. Nonetheless, the court believed that after applying the exclusive pleading test, the insurer's duty to defend would be present if a suit was "potentially" within the policy's coverage. The court concluded that the claim against Gray was potentially within coverage, based on the following reasoning:

Jones' complaint clearly presented the possibility that he might obtain damages that were covered by the indemnity provisions of the policy. Even conduct that is traditionally classified as "intentional" or "wilful" has been held to fall within indemnification coverage. Moreover, despite Jones' pleading of intentional and wilful conduct, he could have amended his complaint to allege merely negligent conduct. Further, plaintiff might have been able to show that in physically defending himself, even if he exceeded the reasonable bounds of self-defense, he did not commit wilful and intended injury, but engaged only in nonintentional tortious conduct.<sup>139</sup> Thus, even accepting the

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135. 65 Cal. 2d at 268, 419 P.2d at 171, 54 Cal. Rptr. at 107.

136. The court believed that the clause was unclear because the nature of its relationship to the basic promise requiring the insurer to defend a suit alleging bodily injury was obscure. Consequently, the court stated, "the basic promise would support the insured's reasonable expectation that he had bought the rendition of legal services to defend against a suit for bodily injury which alleged he had caused it, negligently, nonintentionally, intentionally or in any other manner." 65 Cal. 2d at 273, 419 P.2d at 174, 54 Cal. Rptr. at 110. Thus, the court necessarily interpreted the following language as not including any reference to exclusionary provisions: "[T]he company shall defend any suit . . . alleging such bodily injury or property damage and seeking damages which are payable under the terms of this endorsement . . ." *Id.* at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106 (emphasis added). Although this is a strained view of the clause, the court supported its argument by finding that the exclusionary provision was not conspicuous. *See Comment, supra* note 13.

137. 65 Cal. 2d at 268-75, 419 P.2d at 171-75, 54 Cal. Rptr. at 107-11; *see supra* notes 108-10 and accompanying text.

138. *Accord* Lawler Mach. & Foundry Co. v. Pacific Indem. Ins. Co., 383 So. 2d 156 (Ala. 1980); *McGroarty v. Great Am. Ins. Co.*, 36 N.Y.2d 358, 329 N.E.2d 172, 36 N.Y.S.2d 485 (1975).

139. *But see* *Briscoe v. Travelers Indem. Co.*, 18 Wash. App. 662, 571 P.2d 226 (1971).

insurer's premise that it had no obligation to defend actions seeking damages not within the indemnification coverage, we find, upon proper measurement of the third party action against the insurer's liability to indemnify, it should have defended because the loss could have fallen within that liability.<sup>140</sup>

The court observed that the potential of coverage was even more evident because of a plaintiff's penchant for "draft[ing] its complaint in the broadest terms."<sup>141</sup> Thus, even though an act may be negligent, or at least unintentional, a plaintiff may allege an intentional act to enhance settlement prospects or provide for the recovery of punitive damages.<sup>142</sup> Since the court under the exclusive pleading test may only look to the pleadings, which may be deliberately overstated and inaccurate, a stranger over whom the insured has no control would determine the insured's right to a defense. The court rejected this result: "In light of the likely overstatement of the complaint and of the plasticity of modern pleading, we should hardly designate the third party as the arbiter of the policy's coverage."<sup>143</sup>

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In *Briscoe* the complaint alleged an intentional tort of assault and battery. The insured argued that intentional acts resulting in unintended consequences fall within the policy definition of "accident," and therefore the insurer should have defended, especially when the insured acted in self-defense. The court disagreed, quoting with approval *Hartford Accident & Indem. Co. v. Krekeler*, 363 F. Supp. 354, 357-58 (E.D. Mo. 1973), *rev'd on other grounds*, 419 F.2d 884 (8th Cir. 1974):

Krekeler argues that, while he may have intentionally struck Donato, he did so in self-defense not intending to physically injure him. Assuming that Krekeler's defense of self-defense overcomes Donato's claim, it is inescapable that Krekeler intended the movement of his own arm, the clenching of his fist, and the forceful contact between his fist and Donato's body. It belies reason to say that he did not intend to physically injure Donato. Why else the contact between fist and nose?

18 Wash. App. at 667, 571 P.2d at 229.

140. 65 Cal. 2d at 277, 419 P.2d at 177, 54 Cal. Rptr. at 113.

141. *Id.* at 276, 419 P.2d at 176, 54 Cal. Rptr. at 112.

142. *See supra* notes 47-50 and accompanying text.

143. 65 Cal. 2d at 276, 419 P.2d at 176, 54 Cal. Rptr. at 112; *see also* *Firco, Inc. v. Fireman's Fund Ins. Co.*, 173 Cal. App. 2d 524, 343 P.2d 311 (1959). In *Firco* the insured sought declaratory relief against its insurer, who refused to defend against an action for wrongful removal of timber. The insurer argued that the refusal was justified because the complaint alleged an intentional tort beyond the policy's coverage. The court rejected the insurer's position, holding that since the insured's entry might be deemed unintentional, and thus within the policy's coverage, the insurer must defend, at least until the claim was undeniably confined to a noncovered event. The court analogized the case to *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949) (doubt resolved in favor of insured), explaining that the claim may, or may not, be within coverage. In any event, the allegations, which excluded coverage, could not conclusively control the duty to defend.

Current procedural rules shaped the court's view of the exclusive pleading test:

[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.

Since modern procedural rules focus on the facts of a case rather than the theory of recovery in the complaint, the duty to defend should be fixed by the facts which the insurer learns from the complaint, the insured, or other sources. An insurer, therefore, bears a duty to defend its insured whenever it ascertains facts which give rise to the potential of liability under the policy.<sup>144</sup>

*Gray v. Zurich Insurance Co.* therefore establishes that the insurer must defend complaints alleging intentional injuries because these allegations inherently carry the potential for recovery under alternative theories of negligence. This principle applies despite the possibility that the claim and the plaintiff's judgment will fall outside the duty to indemnify.

Although one commentator has criticized the *Gray* holding,<sup>145</sup> several courts have followed *Gray's* lead when faced with a complaint that expressly excludes coverage.<sup>146</sup> Some courts<sup>147</sup> temper

144. 64 Cal. 2d at 276, 419 P.2d at 176-77, 54 Cal. Rptr. at 112; see also *Solo Cup Co. v. Federal Ins. Co.*, 619 F.2d 1178 (7th Cir. 1980). In *Solo Cup* one of Solo's employees filed a formal charge against the company with the Equal Employment Opportunity Commission ("EEOC"). The EEOC, in turn, brought an action against the insured, alleging intentional employment discrimination. The insurer refused to defend because the policy only covered "occurrences," which the policy defined as an unintentional accident. The insured then settled with the employee and sought to recoup its costs incurred in defending the action from the insurer. The court held that although the complaint alleged an intentional injury, the insurer had to defend. The court reasoned that the plaintiff could have proved an EEOC violation on two distinct grounds: disparate treatment or disparate impact. Because the latter does not require the plaintiff to prove intent, the complaint contained a possibility of coverage which triggered a duty to defend. *But see American Home Assurance Co. v. Diamond Tours & Travel*, 78 A.D.2d 801, 433 N.Y.S.2d 116 (1980) (insurer had no duty to defend complaint alleging policy exclusions of fraud and willful misrepresentation even though insured might have been liable for only negligent misrepresentation within policy's coverage), *rev'g* 103 Misc. 2d 733, 426 N.Y.S.2d 897 (Sup. Ct.).

145. Note, *supra* note 121.

146. See, e.g., *Conner v. Transamerica Ins. Co.*, 496 P.2d 770 (Okla. 1972):

It is certainly not consonant with the objects to be accomplished by a professional insurance policy to say that by its terms no protection is afforded the insured when *groundless* charges of fraud and dishonesty are alleged in a suit against him. This must be so unless the exclusionary clause covers groundless, false and fraudulent charges by express reference.

*Id.* at 775 (emphasis added).

147. See, e.g., *Raday v. Board of Educ.*, 130 N.J. Super. 552, 328 A.2d 17 (App. Div.

the *Gray* result by holding that if the complaint alleges an excluded intentional injury, *and* the underlying tort litigation will not necessarily decide the question of coverage,<sup>148</sup> then mere examination of the third-party complaint cannot determine the duty to defend. In these cases the actual facts will govern the duty to defend. Other courts conclude that if the complaint, without amendment, can impose liability for conduct the policy covers, the insurer is put on notice of the possibility of coverage and must defend despite the allegations of an excluded event.<sup>149</sup>

Although their reasoning differs, these cases all share a common theme: If the complaint alleges an intentional injury exclusion, the insurer cannot simply rely upon the exclusive pleading test to avoid a defense obligation. Instead, courts hold that the insurer must either defend notwithstanding allegations of acts not covered by the policy,<sup>150</sup> or *only if* the proven actual facts indicate the inapplicability of a policy exclusion.<sup>151</sup>

Although the *Gray* decision supporting the former view is generally well-reasoned, it is too expansive in that the insurer must defend a complaint against the insured when any possibility of coverage exists. This means that an insurer must defend virtually

1974).

148. *Id.* at 556, 328 A.2d at 19. In *Raday* the insured brought a third-party complaint against its insurer who had refused to defend against the underlying claim of assault and battery. The tort trial ended in favor of the insured, but the trial judge ordered a new trial. The insured then moved for a declaratory judgment to recover its costs of defense for the main action.

The Superior Court of New Jersey noted that the underlying trial would not necessarily resolve the question of coverage. The court held that under these circumstances the actual facts, rather than the allegations of the complaint, would govern the duty to defend. On remand the actual facts would be established in the tort trial by submitting written interrogatories to the jury. *Id.* at 557, 328 A.2d at 20.

149. *Farris v. United States Fidelity & Guar. Co.*, 273 Or. 628, 542 P.2d 1031 (1975). The complaint alleged that the insureds, as well as their servants and agents, committed tortious acts, and that the insureds directed and ratified the acts. Since the plaintiff could have recovered on a theory of respondeat superior without proving that the insureds directed the acts of their agents (i.e., the plaintiff could have recovered on a covered claim without amending the complaint), the insurer owed a duty to defend.

*See also Ferguson v. Birmingham Fire Ins. Co.*, 254 Or. 496, 460 P.2d 342 (1968) (allegation of willful trespass against insured triggered duty to defend, despite policy exclusion, because plaintiff could have recovered for nonwillful entry without amending his complaint); *Parker v. Hartford Fire Ins. Co.*, 222 Va. 33, 278 S.E.2d 803 (1981) (complaint alleged intentional trespass; insured had duty to defend because the pleadings, without amendment, could have supported judgment for unintentional trespass). *But see Argonaut Southwest Ins. Co. v. Maupin*, 485 S.W.2d 291 (Tex. Civ. App. 1972) (allegation of trespass within exclusion; therefore, no duty to defend existed).

150. This was the holding in *Gray*. *See supra* notes 130-45 and accompanying text.

151. *Raday v. Board of Educ.*, 130 N.J. Super. 552, 328 A.2d 17 (App. Div. 1974).

every suit against the insured<sup>152</sup> because of the chance that the plaintiff, for example, will amend his complaint to include a covered injury. Moreover, even if an intentional act is proved, apparently negating coverage, a finding of an *unintended result* may still bring the claim within the policy's coverage.<sup>153</sup> The effect of the *Gray* holding that the insurer must defend a complaint alleging assault and battery, even though the actual facts conform to the allegations, is to eliminate the intentional injury exclusion from the resolution of the duty to defend issue. The exclusionary provision, according to *Gray*, will only affect the question of indemnity.<sup>154</sup>

Perhaps the better view is that of the Supreme Court of New Jersey.<sup>155</sup> If the complaint alleges an intentional injury excluded from a policy's coverage, such as assault and battery, and the tort trial will not necessarily determine the question of coverage, the allegations should not determine the existence of a duty to defend. Instead, under these circumstances the established actual facts will govern the defense obligation. The rationale is that an allegation of an intentional injury is simultaneously within and excluded from coverage:

\* \* \* The exclusion of intentional injury is somewhat unique with respect to the problem of coverage. The usual coverage issue depends upon status, time, place, identity of the instrumentality, and the like. But in the case of the exclusion of intentional injuries, the injuries, which otherwise are within the coverage, are excepted therefrom because of a state of mind, and indeed a state of mind which the injured claimant may but need

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152. The *Gray* court suggested two situations in which the insurer need not defend: when "the policy was not in force at the time of the alleged occurrence [and] if the nature of the alleged intentional tort compels a finding of intentional wrongdoing such as malicious prosecution." 65 Cal. 2d at 276 n.15, 419 P.2d at 176 n.15, 54 Cal. Rptr. at 112 n.15; see Note, *supra* note 121, at 1330.

153. See *supra* note 55.

154. The *Gray* court's conclusion that the exclusionary provision does not affect the extent of the duty to defend clause is anathema to the policy language: "[T]he company shall defend any suit against the insured alleging such bodily injury or property damage and seeking damages which are payable under the terms of this endorsement, even if any of the allegations are groundless, false or fraudulent . . ." 65 Cal. 2d at 267, 419 P.2d at 170, 54 Cal. Rptr. at 106 (emphasis added). The language used clearly qualifies the types of claims the insurer expects to defend as those that would be payable under the indemnity provisions of the policy. The court rejected this argument by ignoring the phrase "which are payable under the terms of this endorsement." *But cf.* *Steyer v. Westvaco Corp.*, 450 F. Supp. 384, 389 (D. Md. 1978) (both duty to defend and duty to pay depend on scope of coverage underlying policy).

155. *Raday v. Board of Educ.*, 130 N.J. Super. 552, 328 A.2d 17 (App. Div. 1974).

not allege or prove, to prevail against the insured. *Since a claimant who charges intentional injury may thus recover even though the intent to injure is not proved, his complaint, on its face, is simultaneously within both the basic covenant to pay and the intentional injury exclusion from that coverage.*<sup>156</sup>

In summary, when the complaint alleges an intentional injury exclusion, the insurer under the various modern approaches would not be able to use the exclusive pleading test to "construct a formal fortress" of the third-party complaint.<sup>157</sup> Several factors militate against the application of the exclusive pleading test in this context: (1) the plaintiff's tendency to overstate his claim; (2) the liberal rules of amendment; (3) intentional acts may result in only unintended consequences that may still be within coverage; and (4) the realization that allegations of an intentional injury are simultaneously within and outside the coverage provisions of the policy. If the allegations are not determinative, the actual facts established at trial would govern the existence of the duty to defend. If, then, the underlying trial results in a jury verdict for the insured, or the plaintiff changes his theory to negligence, the duty to defend attaches. If, however, the jury finds for the injured party, then it should also determine, and indicate by written interrogatories, whether the act resulted in an intended injury. Accordingly, the insurer would only pay for what it has promised.

C. SITUATION 3: *The allegations against the insured are unclear, conclusory, or ambiguous as to coverage; the unpleaded actual facts indicate, or are compatible with coverage.*

As discussed earlier, the exclusive pleading test requires the insurer to compare the third-party complaint to the policy, and if any of the claims are within, or potentially within coverage, the insurer must defend the insured. Suppose the complaint inadequately describes the nature of the claim so that the insurer cannot in good faith determine whether coverage exists. May the insurer safely rely on the exclusive pleading test and conclude that since the complaint does not state a claim within coverage, there is no duty to defend? Suppose the insurer knows or could reasonably ascertain facts that would indicate coverage. Should the insurer assume a duty to defend, or simply disregard these facts and dis-

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156. *Id.* at 556, 328 A.2d at 19 (emphasis added) (quoting *Burd v. Sussex Ins. Co.*, 56 N.J. 383, 388, 267 A.2d 7, 12 (1970)).

157. *See supra* note 144.

claim coverage? These questions indicate one of the major flaws in the exclusive pleading test. The test evolved when pleading rules required detailed factual complaints. Indeed, the exclusive pleading test is based on, and even presupposes, the existence of detailed factual pleadings that would clarify whether coverage exists or not. These underlying assumptions are no longer true under notice pleading.

Frequently, a modern complaint does not adequately describe facts concerning coverage. This is attributable to two causes. First, the injured party usually is not aware of the terms of the defendant's insurance policy; its complaint therefore may not include facts that would be essential to a determination of coverage.<sup>158</sup> For instance, if a plaintiff sues an insured for injuries resulting from an automobile accident, the plaintiff's complaint might not indicate the make and year of the insured's car.<sup>159</sup> Or if a plaintiff's property is damaged owing to an insured's business operations, the plaintiff could certainly state a cause of action without indicating which of the defendant's business operations was involved.<sup>160</sup> In short, a plaintiff's ability to state a cause of action is not dependent upon a statement of facts pertinent to coverage under the defendant's insurance policy; indeed, facts central to the coverage issue may not be germane to the underlying tort trial.<sup>161</sup>

The second, closely related reason is that notice pleading only requires the plaintiff to provide a summary statement of his claim.<sup>162</sup> In this pleading environment, the plaintiff may choose to plead only those matters essential to state a cause of action that will survive a motion to dismiss, and await discovery to uncover other facts relevant to the claim.<sup>163</sup> Accordingly, the complaint may not fairly apprise the insured or its insurer whether either coverage or an exclusion exists.<sup>164</sup>

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158. A plaintiff's attorney should learn all he can about the existence of any insurance policies, and then draft his complaint so as to include, if possible, a cause of action within coverage. Then, if the plaintiff obtains a judgment against the insured, the plaintiff, as assignee, can recover attorney's fees for the insurer's wrongful refusal to defend.

159. See *Rowell v. Hodges*, 434 F.2d 926 (5th Cir. 1970); *supra* notes 64-65 and accompanying text.

160. See *Tennessee Corp. v. Lamb Bros. Constr. Co.*, 265 So. 2d 533 (Fla. 2d DCA 1972); *supra* notes 57-65 and accompanying text.

161. See, e.g., *New Hampshire Ins. Co. v. Christy*, 200 N.W.2d 834 (Iowa 1972); see also *infra* notes 172-78 and accompanying text.

162. See *supra* notes 103-07 and accompanying text.

163. *Ross Island Sand & Gravel Co. v. General Ins. Co. of Am.*, 472 F.2d 750, 752 (9th Cir. 1973).

164. "It of course follows that 'notice' pleading permitted under the federal rules makes

Most courts hold that when the complaint provides insufficient facts for a determination of coverage, but the insurer knows or could reasonably ascertain the unpleaded true facts that would bring the claim within coverage, the actual facts control and establish the insurer's duty to defend.<sup>165</sup> In *Pacific Indemnity Co. v. Run-A-Ford Co.*,<sup>166</sup> an employee of the insured, a package delivery company, left a parcel at the plaintiff's house against the front door when he found no one home. The plaintiff entered through the rear door and injured herself later when she exited out the front and tripped over the parcel.<sup>167</sup>

The insurance policy in *Run-A-Ford* covered accidental injuries "arising out of the ownership, maintenance or use of the [insured] automobile."<sup>168</sup> The plaintiff's complaint alleged only that the negligent placement of the parcel was the proximate cause of her injuries, but did not refer to the use of the insured vehicle.

Because its obligation to defend did not appear from the allegations of the complaint, the insurer contended that it had no duty to defend; moreover, the pertinent unpleaded facts were irrelevant to the determination of the duty to defend. The Supreme Court of Alabama rejected this position, holding that when the complaint's allegations inadequately resolve the coverage issue in a declaratory judgment action, the court could examine the facts actually proved by admissible evidence.<sup>169</sup> The court decided not to be constrained by the language of the duty to defend provision and proceeded to adopt its own construction:

The question is: Is insurer's agreement, to defend any suit "alleging such injury," to be construed as an agreement to defend only a suit in which the complaint, in itself and without the aid of other facts, contains allegations sufficient to establish the conclusion that the injury alleged is covered by the policy; or, is the agreement to be construed as one to defend a suit in which the complaint alleges an injury which is within the policy coverage but can be shown to be within the coverage only when facts,

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difficult application of the principle that the insurer's duty to defend is to be determined by the plaintiff's complaint—a doctrine which was developed when pleadings were considerably more specific." *Babcock & Wilcox Co. v. Parsons Corp.*, 430 F.2d 531, 536 (8th Cir. 1970).

165. *Metcalfe Bros. v. American Mut. Liab. Ins. Co.*, 484 F. Supp. 826 (W.D. Va. 1980) (complaint did not indicate whether decedents were insured's employees, but insurer knew actual facts; insurer had duty to defend under policy covering injuries resulting in death to employees acting within course of their employment).

166. 276 Ala. 311, 161 So. 2d 789 (1964).

167. *Id.* at 313, 161 So. 2d at 789-90.

168. *Id.* at 314, 161 So. 2d at 790.

169. *Id.* at 318-19, 161 So. 2d at 795.



which do exist but are not alleged in the complaint, are taken into consideration? *The policy does not provide which construction shall be adopted.* Under the rule that the policy must be liberally construed in favor of the insured, the latter construction must be adopted. Under the latter construction, facts not alleged in the complaint may be considered.<sup>170</sup>

Under the actual facts in *Run-A-Ford*, the injury stemmed from the use of the insured vehicle and consequently was within the policy's coverage. As a result, the insurer had breached its duty to defend despite the omission of these facts from the allegations of the complaint.<sup>171</sup>

In *New Hampshire Insurance Co. v. Christy*,<sup>172</sup> the Supreme Court of Iowa reached the *Run-A-Ford* result, albeit on different grounds. In *Christy* the insurer brought a declaratory judgment action to determine its liability under an insurance policy issued to Mr. Christy. The policy covered him, members of his household, and any person driving with his permission, but not cars owned by others.<sup>173</sup>

Evidently, Christy's married daughter, Mrs. Sankey, was involved in a traffic accident while driving Mrs. Christy's Buick. The insurer refused to defend a negligence action against Sankey because the complaint did not reveal who owned the Buick.<sup>174</sup> At the trial of the insurer's action for a declaratory judgment, in which Sankey counterclaimed to recover the costs of defense, no proof was offered that would have attacked her status as an insured. Rather, the insurer contended that it was not liable on the ground that Sankey owned the Buick.<sup>175</sup> The insurer argued that its refusal to defend was justified under the exclusive pleading test.

While noting the general propriety of the exclusive pleading test, the court concluded that the test was inapplicable because of

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170. *Id.* (emphasis added).

171. On the issue of coverage, the court decided that the process of taking the package from the truck and placing it on the porch arose from the use of the truck and was therefore within the policy's coverage. *Id.* at 315, 161 So. 2d at 792.

172. 200 N.W.2d 834 (Iowa 1972).

173. *Id.* at 836.

174. Specifically, the complaint did not disclose whether the defendant was driving with the permission of the named insured, whether the insured owned the automobile, or whether the defendant was a member of the named insured's household. As discussed earlier, *supra* notes 148 & 161 and accompanying text, these facts were irrelevant to the plaintiff's claim for negligence.

175. The jury found, in response to a written interrogatory, that Mrs. Sankey was not the car's owner. 200 N.W.2d at 837.

the extraneous facts in the record.<sup>176</sup> The court reasoned that the facts essential to the question of coverage<sup>177</sup> were not necessary to the plaintiff's allegations in a claim for negligence. Moreover, even if the facts were alleged in the complaint, the underlying trial between the insured and the plaintiff would focus on Sankey's negligence, and would not necessarily resolve the factual issue concerning coverage.<sup>178</sup> The court concluded,

Since the draftsman of a pleading against the insured is not ordinarily interested in the question of coverage which later arises between the insurer and insured, an insured's right to a defense by its insurer should not be made to depend upon the allegations a third party chooses to put in his petition.<sup>179</sup>

The *Christy* rationale differs considerably from that in *Run-A-Ford*. The *Run-A-Ford* court found the duty to defend clause ambiguous and concluded that its language did not support the use of the exclusive pleading test.<sup>180</sup> The *Christy* court ignored the possible ambiguity of the clause and decided instead that the exclusive pleading test is inapplicable whenever a complaint fails to determine coverage.<sup>181</sup>

Some jurisdictions have adopted a third approach requiring the insurer to investigate the underlying facts whenever the complaint fails to determine coverage. If the insurer investigates and learns of the true facts bringing the claim within coverage, it must

176. *Id.* at 839.

177. *See supra* note 174.

178. The allegations in a pleading are not, in all circumstances and situations, the decisive factor in determining whether there exists a duty on the part of the insurance company to defend. This is especially true when the duty to defend depends upon a factual issue which will not be resolved by the trial of the third party's suit against the insured, the duty to defend may depend upon the actual facts and not upon the allegations in the pleading.

. . . .  
 . . . In order to state a cause of action under these circumstances plaintiff was required to allege [the insured] was negligent, . . . that her negligence was a proximate cause of the [plaintiff's] injuries and the amount and extent of damages claimed. It was not essential in order to state a cause of action upon which relief could be granted . . . that plaintiff allege those matters the insurance company claims were omitted from the . . . petition. *In fact, evidence tending to support those facts would have been irrelevant in the trial of the [negligence] action.*

200 N.W.2d at 838 (emphasis added); *see supra* note 148.

179. 200 N.W.2d at 838.

180. This rationale is potentially broader than that used in *Christy*; indeed, the *Run-A-Ford* court's finding that the duty to defend clause is ambiguous implies that the court could reject the exclusive pleading test under all circumstances.

181. 200 N.W.2d at 838-39.

defend the entire suit. As a corollary, if the insurer refuses to investigate the facts, and the court later finds that the insurer knew, or should have known, of the true but unpleaded facts, the insurer will be liable for the costs of defense.<sup>182</sup>

A Washington appellate court specifically imposed this duty to investigate on the insurer in *Insurance Co. of North America v. Insurance Co. of Pennsylvania*.<sup>183</sup> The insured's pilot attempted to extinguish a cigarette on the fuselage of a helicopter. A forest fire resulted and another helicopter crashed, killing a firefighter standing on the ground. The insured had two insurance policies: an aviation policy covering injuries arising out of the use of the aircraft; the other expressly excluded such injuries.<sup>184</sup>

The insurer who had issued the aviation policy refused to defend on the ground that the complaint did not allege a covered claim.<sup>185</sup> The Washington court acknowledged the exclusive pleading test, but refused to apply it because under the circumstances the complaint failed to adequately resolve the issue of coverage.<sup>186</sup> Instead, the court imposed upon the insurer a duty to investigate the underlying facts to determine whether its policy actually covered the event.<sup>187</sup>

182. *Farmer's Home Mut. Ins. Co. v. Insurance Co. of N. Am.*, 20 Wash. App. 815, 583 P.2d 644 (1978), *review denied*, 91 Wash. 1014, *cert. denied*, 442 U.S. 942 (1979).

183. 17 Wash. App. 331, 562 P.2d 1004 (1977).

184. *Id.* at 333, 562 P.2d at 1005.

185. The pertinent allegation read: "The fire . . . was started by the defendant EMCO Helicopters, Inc.'s negligence, in that one of its employees acting within the scope and duties of his employment carelessly and negligently failed to extinguish a cigarette, which cigarette ignited forest debris and resulted in the fire." *Id.* at 334, 562 P.2d at 1005. Since the plaintiff did not allege that the employee was operating the helicopter at the time of the incident, the insurer felt justified in refusing to defend.

186. *Id.*

187. "[I]f the allegations of the third party's complaint are inadequate to determine the character of the claim, the facts giving rise to the potential liability must be investigated." *Id.* (citations omitted). Other jurisdictions have reached the same result without necessarily imposing a duty to investigate. Thus, in *Associated Indem. Co. v. Insurance Co. of N. Am.*, 68 Ill. App. 3d 807, 386 N.E.2d 529 (1979), the court stated:

[E]ven though the complaint, standing alone, may not fairly apprise the insurer that the third party is suing the putative insured on an occurrence potentially within the policy's coverage, the insurer is obligated to conduct the putative insured's defense if the insurer has knowledge of true but unpleaded facts, which, taken together with the complaint's allegations, indicate that the claim is within . . . the policy's coverage. . . . To hold otherwise would allow the insurer to construct a formal fortress of the third party's pleadings and to retreat behind its walls, thereby successfully ignoring true but unpleaded facts within its knowledge that require it, under the insurance policy, to conduct the putative insured's defense.

*Id.* at 816-17, 386 N.E.2d at 536 (emphasis added; footnote and citations omitted). The

Thus, under the third factual possibility, if the complaint is unclear or ambiguous as to coverage, and the insurer knows or could reasonably ascertain that the unpleaded facts indicate that the claim is within coverage, the insurer cannot rely on the exclusive pleading test to avoid its duty to defend. In this situation the exclusive pleading test is inefficacious because its rationale depends upon a definitive statement of facts that clarifies the coverage issue. Unless the allegations are detailed, the existence of an insurer's duty to defend should depend upon the unpleaded actual facts showing coverage.

**D. SITUATION 4: *The allegations are unclear, conclusory, or ambiguous as to coverage; the unpleaded actual facts indicate noncoverage or the applicability of an exclusion.***

If the factual test applies to require the insurer to defend a suit when the complaint is ambiguous as to coverage and the actual facts show coverage, should the factual test also apply to relieve an insurer of its defense obligation when the complaint is ambiguous and the true facts show noncoverage or the applicability of a policy exclusion? Basic fairness dictates that the same rule should apply in both situations. When the complaint is inconclusive, perhaps courts would not hesitate to apply the factual test to relieve an insurer of its duty to defend as long as the parties are on an equal footing. In fact, however, the parties usually are not equally situated. Most courts recognize that the duty to defend clauses—as well as other insurance policy provisions—are standardized and not subject to alteration through rigorous negotiation.<sup>188</sup>

Since insurance policies are generally deemed to be adhesion contracts,<sup>189</sup> a court might justifiably refuse to apply the factual test in situation (4). This will prevent an insurer from avoiding its defense obligation. Moreover, the significant distinction between

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court refused to impose an affirmative duty to investigate, but noted that its holding was limited to unpleaded facts brought to the insurer's attention and known to be correct. *Id.* at 817 n.5, 386 N.E.2d at 536 n.5.

Approximately a year later, in *La Rotunda v. Royal Globe Ins. Co.*, 87 Ill. App. 3d 446, 408 N.E.2d 928 (1980), the court held that when the insurer learned through its own investigation that a policy exclusion might not apply, and the complaint did not conclusively establish coverage or an exclusion, the court would deem the results of the insurer's investigation to be "unpleaded [facts] known to the insurer which indicate that the claim was potentially within the policy's coverage." *Id.* at 452, 408 N.E.2d at 934.

188. See *supra* note 111 and accompanying text.

189. *Id.*

fact patterns (3) and (4) justifies a court's refusal to apply the same rule in both factual settings. Invariably, the court will resolve all doubts in favor of the insured because of the parties' disparate bargaining power.<sup>190</sup> To accomplish this, the court will broadly construe in the insured's favor all provisions of the contract sustaining coverage, and narrowly construe all provisions excluding coverage.<sup>191</sup>

Thus, in situation (3), when the complaint does not definitively establish coverage but the actual facts indicate coverage, a court should apply the factual test and find a duty to defend. In situation (4), however, the insurer is attempting to avoid its defense obligation on the basis of an exclusionary provision. Because exclusionary provisions are narrowly construed, and the complaint raises doubts as to their application, a court should resolve the ambiguity in favor of the insured and refuse to apply the factual test if it would negate the defense obligation. If a court were to apply the factual test equally in both situations, it would give the same weight and consideration to both an exclusionary provision and a basic coverage provision. This, of course, would violate the principle that the two provisions should be treated differently.

A narrow reading of *Lee v. Aetna Casualty & Surety Co.*<sup>192</sup> supports this argument. One could not determine from the complaint in *Lee* whether the plaintiff's injuries were excluded from coverage under the policy exclusion relating to the "use" of an elevator. The *Lee* court found that the injuries did in fact result from a use of the elevator within the policy exclusion. Consequently, the insurer had no duty to indemnify.<sup>193</sup> Because the complaint did not resolve the question whether the exclusion applied, the *Lee* court believed the resolution of the doubt as to the duty to defend should be in the insured's favor. The court concluded that the actual facts indicative of an exclusion were irrelevant if the complaint did not clearly reveal an exclusion: "When, . . . as here, the complaint comprehends an injury which may be within the policy, we hold that the promise to defend includes it."<sup>194</sup>

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190. See, e.g., *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); *West v. MacDonald*, 103 N.J. Super. 201, 247 A.2d 20 (App. Div. 1967).

191. See *supra* notes 111-13 and accompanying text.

192. 178 F.2d 750 (2d Cir. 1949) (L. Hand, J.); see *supra* notes 14-21 and accompanying text.

193. 178 F.2d at 751.

194. *Id.* at 753; see, e.g., *Brooklyn & Queens Allied Oil Burner Serv. Co. v. Security Mut. Ins. Co.*, 27 Misc. 2d 401, 208 N.Y.S.2d 259 (Sup. Ct. 1960). *But cf.* *Ross Island Sand & Gravel Co. v. General Ins. Co.*, 472 F.2d 750 (9th Cir. 1973). In *Ross Island* the complaint

Once courts accept the position that the insurance policy is an adhesion contract executed by parties having unequal bargaining power, the courts should compensate for this disparity by refusing to apply the factual test when the complaint is ambiguous as to coverage but the actual facts show an exclusion. Only when an excluded claim clearly appears on the face of the complaint,<sup>195</sup> and that claim necessarily and inexorably falls within the policy exclusion, should the court indulge the insurer by finding that no duty to defend exists.<sup>196</sup>

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was too general for a determination of whether the claim was for covered damages. The actual facts elicited through discovery showed an exclusion, but the insured argued that under Oregon's code pleading system the exclusive pleading test applied. The court disagreed because the plaintiff had commenced the action in federal court; under notice pleading, the actual facts, rather than the allegations of the complaint, determined the defense obligation. Accordingly, no duty to defend existed because the facts showed an exclusion.

195. See, e.g., *Mol v. Holt*, 86 Ill. App. 3d 838, 409 N.E.2d 20 (1980). In *Holt* a car accident occurred between Mr. Holt and the plaintiffs. The insurance company had issued the policy to Holt's mother and designated a 1969 Volkswagen as the insured vehicle. The policy covered any resident of the insured's household. The policy also covered any additional vehicle, if proper notice of acquisition was given within thirty days of purchase. The complaint indicated that Holt was driving a 1967 Camaro, but did not contain any allegations about the vehicle's ownership or that Holt and the insured were related. After tender of the complaint, the insurer investigated and discovered that Holt had bought the car but failed to notify the insurer of the purchase, as required. On the basis of the *actual facts*, the insurer refused to defend Holt.

The court held that the refusal was wrongful. When a complaint does not clearly allege facts which, if established, would exclude coverage, the potential of coverage is present, establishing the duty to defend. The insurer could refuse to defend based on a policy exclusion only when "the complaint, on its face, clearly alleges facts which, if true, would exclude coverage . . ." *Id.* at 840, 409 N.E.2d at 22; see also *supra* note 65; cf. *American Employers' Ins. Co. v. Continental Casualty Co.*, 85 N.M. 346, 349, 512 P.2d 674, 677 (1973) ("[T]he duty to defend arises when the facts are not stated with sufficient clarity [to determine] from the face of the complaint whether the action falls within the coverage of the policy.") (citing 1 R. LONG, THE LAW OF LIABILITY INSURANCE § 5.02 (1973)).

196. See *supra* note 56. Not all courts, however, agree with this conclusion. In *Atlantic Mut. Fire Ins. Co. v. Cook*, 619 F.2d 553 (5th Cir. 1980), the court construed Alabama law and held that if a complaint omits certain facts tending to show an exclusion, the exclusive pleading test does not bar the insurer from presenting evidence demonstrating an exclusion in a declaratory judgment action. The suit alleged that the insured grandmother negligently entrusted her grandchild to the care of another, who while driving intoxicated became involved in a car accident that caused the child's death. The mother's complaint omitted any reference to the accident. Not surprisingly, the policy excluded from coverage injuries arising from the use of a car.

In the insurer's action for a declaratory judgment, the defendants argued that because the facts establishing the exclusion were not present on the face of the complaint, the exclusive pleading test compelled a finding of a duty to defend. The court disagreed, however, maintaining that "the insurer is not barred by the silence of the state-court complaint from establishing, by proof of . . . uncontroverted facts, that it had no duty to defend the tort suit because the accident sued upon was excluded from the coverage of its policy." *Id.* at 555. It is difficult to criticize the result of this case because of the possibility of collusion

**E. SITUATION 5: *The allegations and the actual facts conflict. The allegations indicate a policy exclusion; the actual facts indicate coverage or a potential for coverage.***

The fifth factual possibility presents the strongest case for applying the factual test to impose a duty to defend on the insurer. In fact, it is within this factual setting that the so-called exception to the exclusive pleading test originated.<sup>197</sup> One of the principal reasons the factual test, rather than the exclusive pleading test, is applied in this setting is that the contractual language does not decisively establish the parties' rights.<sup>198</sup> The contract obligates the insurer to defend any suit *alleging* a covered claim, even if the allegations are completely groundless or false; the court must determine the defense obligation solely by evaluating the allegations. Thus, if the complaint falsely alleges a covered event, but the insurer knows of true facts which demonstrate that the claim is not covered, the insurer generally is still obligated to defend,<sup>199</sup> owing to its express promise to defend groundless, false, or fraudulent suits.<sup>200</sup>

The converse of this principle, that the insurer need *not* defend if false allegations are indicative of an exclusion but the true facts indicate coverage, does not necessarily follow.<sup>201</sup> As one court

between the plaintiff and her mother. *See also* Ross Island Sand & Gravel Co. v. General Ins. Co., 472 F.2d 750, 752 (9th Cir. 1973) (complaint cast in broad enough terms to require insurer to defend; court not required "to avert its eyes from facts properly before it"); Rowell v. Hodges, 434 F.2d 926 (5th Cir. 1970) (under Florida law actual facts control with no duty to defend when complaint silent as to make and year of car involved in accident, and actual facts show policy did not cover car).

197. *Hardware Mut. Casualty Co. v. Hilderbrandt*, 119 F.2d 291 (10th Cir. 1941), was one of the earliest cases to hold that a duty to defend exists when the false allegations exclude coverage, but the actual facts establish coverage.

198. *See infra* text accompanying notes 253-58.

199. Not all courts agree with this conclusion. For a more extensive discussion of this possibility, see *infra* notes 242-64 and accompanying text.

200. *See Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949); *infra* note 255 and accompanying text; *see also supra* notes 14-22 and accompanying text.

201. The following cases recognize that when the allegations show an exclusion, but the true facts, known to or reasonably ascertainable by the insurer, indicate coverage, the factual test creates a duty to defend: *Bertschinger v. National Sur. Corp.*, 449 F.2d 744 (9th Cir. 1971) (dictum) (applying Alaska law); *Milliken v. Fidelity & Casualty Co.*, 338 F.2d 35 (10th Cir. 1964); *Hagen Supply Corp. v. Iowa Nat'l Mut. Ins. Co.*, 331 F.2d 199 (8th Cir. 1964) (dictum) (interpreting Minnesota law); *American Motorists Ins. Co. v. Southwestern Greyhound Lines*, 283 F.2d 648 (10th Cir. 1960); *Albuquerque Gravel Prod. Co. v. American Employers Ins. Co.*, 282 F.2d 218 (10th Cir. 1960) (dictum); *McGettrick v. Fidelity & Casualty Co.*, 264 F.2d 883 (2d Cir. 1959); *Journal Pub. Co. v. General Casualty Co.*, 210 F.2d 202 (9th Cir. 1954); *Hardware Mut. Casualty Co. v. Hilderbrandt*, 119 F.2d 291 (10th Cir. 1941); *National Indem. Co. v. Flesher*, 469 P.2d 360 (Alaska 1970); *Commercial Union Ins. Co. v.*

argued:

The conclusion that because the insurance company is bound to defend a suit alleging a claim covered by its policy, when in fact the incident giving rise to the claim was outside the scope of, or was expressly excluded from coverage, therefore the company is excused from defending a suit alleging facts not covered by the policy, is a *non sequitur*. In the former case, the express agreement to defend is controlling. In the latter case, there is no express agreement as to the duty to defend, and the rights of the parties must be determined by fairly construing the insurance contract in such a way as to carry out its intended purpose.<sup>202</sup>

Because the insurance policy is arguably silent on the parties' rights,<sup>203</sup> courts can effect a "fair, if extracontractual construction

Henshall, 262 Ark. 117, 553 S.W.2d 274 (1977); *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966) (dictum); *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962); *Spruill Motors, Inc. v. Universal Underwriters Ins. Co.*, 212 Kan. 681, 512 P.2d 403 (1973) (overruling its prior decisions in *Leonard v. Maryland Casualty Co.*, 158 Kan. 263, 146 P.2d 378 (1944) and *Brown v. Green*, 204 Kan. 802, 466 P.2d 299 (1970), which held that an insurer can rely only on the allegations); *Shepard Marine Constr. Co. v. Maryland Casualty Co.*, 73 Mich. App. 62, 250 N.W.2d 541 (1976); *Crum v. Anchor Casualty Co.*, 264 Minn. 378, 119 N.W.2d 703 (1963); *Mavar Shrimp & Oyster Co. v. United States Fidelity & Guar. Co.*, 187 So. 2d 871 (Miss. 1966); *City of Palmyra v. Western Casualty & Sur. Co.*, 477 S.W.2d 428 (Mo. Ct. App. 1972); *R.A. Hanson Co. v. Aetna Ins. Co.*, 26 Wash. App. 290, 612 P.2d 456 (1980) (dictum). *But see* *American Policyholders' Ins. Co. v. Cumberland Cold Storage Co.*, 373 A.2d 247, 250 n.1 (Me. 1977) (dictum).

202. *McGettrick v. Fidelity & Casualty Co.*, 264 F.2d 883, 886 (2d Cir. 1959). In the underlying action in *McGettrick*, an injured customer sued the insured, a restaurant owner, for assault and battery. The policy covered the incident, unless committed by or at the direction of the insured. The insurer declined to defend without investigating the incident to determine whether the insured acted in self-defense. The insured's own attorney had obtained statements from several witnesses showing that the insured had acted in self-defense. *Id.* at 885.

After settling the underlying action, the insured sued to collect its costs of defense. At trial, the jury found that the insured had *not* committed assault and battery, and that the insurance company did not conduct a proper investigation. The court concluded that when the plaintiff falsely alleges an excluded event, but the actual facts indicate coverage, the actual facts control and the insurer has a duty to defend.

203. *See, e.g., Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962):

If the insurer intended otherwise, it could have made its intent clear and unmistakable by undertaking to defend "unless the complaint alleges facts which show the claim to be excluded from coverage," or by using other unambiguous language, for example: "The company shall defend claims and suits, groundless or otherwise, for which it may become liable only when the allegations thereof show injury covered by the policy and do not show the claim to be excluded by the policy."

*Id.* at 293, 127 S.E.2d at 58.



of the insurance policy"<sup>204</sup> in order to fulfill the insured's expectations.<sup>205</sup>

Courts that require an insurer to defend a suit alleging facts within a policy exclusion, when the actual facts trigger coverage, advance various theories for their position. Some courts suggest that the present system of notice pleading<sup>206</sup> renders the application of the exclusive pleading test inappropriate when the known or discoverable true facts diverge from the alleged facts.<sup>207</sup> More recent decisions, however, focus on the reasonable expectations of the weaker party, the insured.<sup>208</sup> In *Loftin v. United States Fire Insurance Co.*,<sup>209</sup> Mr. Loftin, the insured, brought an action to recover attorney's fees and expenses incurred in defending a suit stemming from an automobile collision. The plaintiff in the underlying tort action alleged that she and the driver were Loftin's employees.<sup>210</sup>

The insurer declined to defend since the policy excluded coverage for injuries to employees resulting from the actions of fellow

204. 6 WM. MITCHELL L. REV. 473, 475 (1980).

205. See *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 294, 127 S.E.2d 53, 58 (1962).

206. See, e.g., *Journal Pub. Co. v. General Casualty Co.*, 210 F.2d 202 (9th Cir. 1954): "One of the outstanding facts of modern litigation is the diminishing importance of initial pleadings in the light of the ease of amendment and the use of pretrial proceedings to lay the pleadings on the shelf." *Id.* at 209.

207. See *Milliken v. Fidelity & Casualty Co.*, 338 F.2d 35 (10th Cir. 1964):

This court has consistently held that as a general rule the duty of an insurer to defend its insured in federal court litigation is determined in the beginning of the litigation by the coverage afforded by the policy, as compared with the allegations of the complaint filed in the action. But, the allegations . . . are not conclusive on the issue. The duty to defend may attach at some later stage of the litigation if the issues of the case are so changed or enlarged as to come within the policy coverage. The reason for this rule is that " \* \* \* [u]nder the Federal Rules of Civil Procedure the dimensions of a lawsuit are not determined by the pleadings because the pleadings are not a rigid and unchangeable blueprint of the rights of the parties. \* \* \* " Thus, the insurer's duty to defend an action brought in federal court against its insured may arise or attach at any stage in the litigation. And the duty does attach where there are facts, extraneous to the allegations of the pleadings, which, if proved, make out a case against the insurer [sic] that is covered by the policy and which either are actually brought to the insurer's attention or could have been discovered by it through a reasonable investigation.

*Id.* at 40 (footnotes omitted).

208. See, e.g., *National Indem. Co. v. Flesher*, 469 P.2d 360 (Alaska 1970); *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962). See generally *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 419 P.2d 168, 54 Cal. Rptr. 104 (1966); Note, *supra* note 121, at 1328; *supra* notes 108-10 and accompanying text.

209. 106 Ga. App. 287, 127 S.E.2d 53 (1962).

210. *Id.* at 287-89, 127 S.E.2d at 54-55.

employees.<sup>211</sup> The insured notified the insurer that both the plaintiff and the driver were not employees but independent contractors.<sup>212</sup> The insurer, however, refused to investigate and ascertain the true facts. In the underlying tort litigation, the trial court found, on the basis of the evidence, that the driver was not an employee and accordingly dismissed the claim against the insured.<sup>213</sup>

On appeal the issue was whether the insurer had a duty to defend when the false allegations indicated an exclusion but the actual facts established coverage. The court noted that under this factual situation the contract was ambiguous as to the rights and duties of the policyholder and the insurer.<sup>214</sup> It concluded that the parties could not have intended for the insurer to ignore true facts, placing the burden on the insured to conduct his own defense and prove coverage on the basis of facts already known to the insurer.<sup>215</sup> The court construed the intent of the parties as follows:

We must assume that the insurer's undertaking to defend was intended to afford benefits to the insured. . . . [W]hen untrue facts are alleged in the complaint showing an exclusion from coverage, the insurer need not defend in its own interest, as it would not be liable for a judgment based upon these untrue facts. Hence its undertaking to defend will be of definite benefit to the insured sued by such a complaint when the true facts are within coverage. We may reasonably presume that the undertaking to defend "with respect to the insurance afforded by this policy" was intended to give the insured this benefit—to defend suits when the policy affords insurance according to the true facts.<sup>216</sup>

The *Loftin* court rejected as misleading the suggestion that the allegations should determine the duty to defend. Because the defense obligation is contractual, the contract governs the duty to defend; when the contract is ambiguous, the court must ascertain the intent of the parties.<sup>217</sup>

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211. *Id.* at 288, 127 S.E.2d at 55.

212. Many of the cases under fact situation (5) turn on the insured's relationship with the injured party. *See, e.g.*, *Journal Pub. Co. v. General Casualty Co.*, 210 F.2d 202 (9th Cir. 1954); *Hardware Mut. Casualty Co. v. Hilderbrandt*, 119 F.2d 291 (10th Cir. 1941); *National Indem. Co. v. Flesher*, 469 P.2d 360 (Alaska 1970); *Commercial Union Ins. Co. v. Henshall*, 262 Ark. 117, 553 S.W.2d 274 (1977); *Crum v. Anchor Casualty Co.*, 264 Minn. 378, 119 N.W.2d 703 (1963).

213. 106 Ga. App. at 289, 127 S.E.2d at 55.

214. *Id.* at 292, 127 S.E.2d at 57.

215. *Id.*

216. *Id.* at 293, 127 S.E.2d at 57-58.

217. *Id.* at 294, 127 S.E.2d at 58. The court concluded:

## 1. THE DUTY TO INVESTIGATE

When the complaint alleges facts within a policy exception, and the insured notifies the insurer of contrary facts that ostensibly bring the claim within coverage, many jurisdictions impose upon the insurer an affirmative duty to investigate the facts before declining to defend the claim.<sup>218</sup> The duty to investigate, although perhaps burdensome to the insurer,<sup>219</sup> is the most expeditious approach when the alleged facts conflict with the actual facts and the

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This policy cannot be construed to have intended other than that, when the insured in good faith complies with the terms of the policy requiring him to give notice to the insurer of claims and suits, the insurer undertakes to ascertain the true facts, with respect to an alleged exclusion from coverage and its duty to defend rests thereon. It would not be reasonable to say that it was the intention of the contracting parties, when the insured has given all notice and information required of him, that the assertions of a third party, a stranger to the contract, rather than the true facts, be allowed to determine the rights between the contracting parties, unless such an intention is clearly manifested by the terms of the contract, as in the undertaking to defend groundless suits.

*Id.* at 296, 127 S.E.2d at 59.

218. The rule is stated as follows: The insurer must defend against a complaint alleging facts within a policy exception when it *knows or could reasonably ascertain* facts that indicate coverage. This formulation necessarily forces the insurer to conduct an investigation. If the insurer does not, and the court later rules that the facts were "reasonably ascertainable," the insurer will be liable for breaching its defense obligation. *Bertschinger v. National Sur. Corp.*, 449 F.2d 744 (9th Cir. 1971) (under Alaska law insurer must investigate before declining coverage); *American Motorists Ins. Co. v. Southwestern Greyhound Lines*, 283 F.2d 648, 650 (10th Cir. 1960) (applying Missouri law) ("The record indicates persuasively that through a reasonable investigation, American could readily have ascertained that, despite the allegations contained in the petitions . . . there was substantial evidence available to show that the actual fact . . . was that the passenger fell after alighting from the bus . . ."); *McGettrick v. Fidelity & Casualty Co.*, 264 F.2d 883 (2d Cir. 1959) (applying Vermont law) (investigation would have revealed that insured acted in self-defense rather than the claimed intentional tort of assault and battery); *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962) (investigation would have disclosed that injured party was not insured's employee); *Spruill Motors, Inc. v. Universal Underwriters Ins. Co.*, 212 Kan. 681, 512 P.2d 403 (1973) (insurer refused to defend even though its own investigator concluded that the injury, although alleged as intentional, was more likely unintentional and therefore within coverage); *see also American States Ins. Co. v. Aetna Life & Casualty Co.*, 379 N.E.2d 510 (Ind. Ct. App. 1978); *Johnson v. Aid Ins. Co.*, 287 N.W.2d 663 (Minn. 1980) (while insurer may initially rely on allegations to determine its defense obligation, allegations not decisive; once insured has made some factual showing that claim is covered, insurer must investigate facts).

219. A typical insurance policy reserves to the insurer the right (but not the duty) to investigate the claim brought against the insured. *See supra* note 2. Because insurers investigate as a matter of course to determine the merits of the action against the insured and evaluate settlement prospects, the suggestion that a duty to investigate the facts would be burdensome is unpersuasive. The duty to investigate, moreover, would not arise in every case. In any event, the insurer cannot complain, because it is responsible for the ambiguity that the policy creates in fact situations (3), (4), (5), and (6).

latter indicate coverage.<sup>220</sup> The reason for this is that the question of coverage usually turns on facts that the insurer can determine objectively<sup>221</sup> prior to trial.<sup>222</sup>

One of the major benefits of the exclusive pleading test is that the insurer can determine its duty to defend at the outset of the

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220. Some courts apply a duty to investigate when the complaint is silent on questions of coverage. See *supra* text accompanying notes 158-96; see also *R.A. Hanson Co. v. Aetna Ins. Co.*, 26 Wash. App. 290, 612 P.2d 456 (1980) (although court recognized duty to investigate rule when complaint ambiguous as to coverage, that duty did not attach in this case because complaint was unambiguous).

221. The insurer can objectively determine the applicability of several exclusionary provisions before trial. For example, when a policy excludes injuries to employees, the question of coverage focuses on the relationship between the injured party and the insured. See, e.g., *Journal Pub. Co. v. General Casualty Co.*, 210 F.2d 202 (9th Cir. 1954); *Hardware Mut. Casualty Co. v. Hilderbrandt*, 119 F.2d 291 (10th Cir. 1941); *National Indem. Co. v. Flesher*, 469 P.2d 360 (Alaska 1970); *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962); *Crum v. Anchor Casualty Co.*, 264 Minn. 378, 119 N.W.2d 703 (1963). Other policies exclude injuries that occur in a certain place. Cf. *American Motors Ins. Co. v. Southwestern Greyhound Lines*, 283 F.2d 648 (10th Cir. 1960) (allegation that injury occurred while alighting from bus within express policy exclusion, but jury found that plaintiff was injured *after* alighting; consequently, insurer had duty to defend based on actual facts).

222. When the question of coverage is a subjective matter, depending on the insured's state of mind, some courts hold that the insurer need not investigate or assume the defense until the jury determines the actual facts. In a declaratory judgment action regarding the insurer's duty to defend, the court cannot make any findings as to an alleged intentional injury because this would interfere with the central factual issue in the underlying tort trial. *Harbin v. Assurance Co. of Am.*, 308 F.2d 748 (10th Cir. 1962); *Maryland Casualty Co. v. Peppers*, 64 Ill. 2d 187, 355 N.E.2d 24 (1976); *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 771, 240 A.2d 397 (1968).

In *Harbin* the injured party brought suit in state court on a claim of assault and battery. The insurer then brought a declaratory judgment action in federal court to determine coverage and its duty to defend. In two previous decisions, *American Motorists Ins. Co. v. Southwestern Greyhound Lines*, 283 F.2d 648 (10th Cir. 1960) and *Hardware Mut. Casualty Co. v. Hilderbrandt*, 119 F.2d 291 (10th Cir. 1941), the Tenth Circuit had ruled that the actual facts, rather than the pertinent but false allegations, controlled the duty to defend. The *Harbin* court distinguished the prior cases on the ground that the actual facts had already been established. Because the actual facts were not yet determined in *Harbin*, the insurer did not have a present duty to defend. The court also emphasized that an investigation into the subjective question of intent was not required:

The insurer's liability depends on whether the injury was caused intentionally by the insured. The difficulty in the ascertainment of a state of mind needs no amplification. Reasonable men may understandingly differ as to the intent of another because they may draw conflicting inferences from physical facts. For this reason the argument that the insurer should have conducted an investigation and relied on the results thereof does not persuade us. *Intent is to be determined, not by the insurer's investigators, but by the finder of the facts in the lawsuit brought by the claimant of the injuries.*

*Harbin*, 308 F.2d at 749-50 (emphasis added). But cf. *McGettrick v. Fidelity & Casualty Co.*, 264 F.2d 883 (2d Cir. 1959); *Spruill Motors, Inc. v. Universal Underwriters Ins. Co.*, 212 Kan. 681, 512 P.2d 403 (1973). *McGettrick* and *Spruill* recognized that when the complaint alleges an intentional injury that is excluded from the policy's coverage, the insurer is obligated to defend based on facts ascertained during the insurer's investigation.

litigation by comparing the complaint with the insurance policy. The factual test, however, does not share this advantage because the actual facts presumably remain unproven until after the completion of the underlying trial. The duty to investigate corrects this apparent flaw in the factual test. Since the application of most exclusionary provisions depends upon facts that the insurer can objectively determine before trial,<sup>223</sup> the insurer's investigation will enable it to determine its defense obligation soon after the lawsuit is filed.<sup>224</sup>

Once the insurer has investigated, it should assume the defense of the complaint against the insured if the insurer has discovered facts indicating the *possibility* (not the probability) of coverage.<sup>225</sup> In the usual case when the status of the injured party<sup>226</sup> or the identity of the instrumentality causing injury<sup>227</sup> is at issue, the insurer's investigation will result in a definitive finding. In some cases, however, an insurer's investigation may not definitively resolve the question of coverage, because either the insured's state of mind is at issue,<sup>228</sup> or coverage depends upon a close question of

223. See *supra* cases cited note 221.

224. In *Hardware Mut. Casualty Co. v. Hilderbrandt*, 119 F.2d 291 (10th Cir. 1941), the court quoted from the insured's brief a hypothetical case which illustrates this principle:

A owns two automobiles, a Ford and a Nash. The Ford is covered by the policy of the company but the Nash is not. A, while driving the Ford, negligently injures a third party and this party brings an action for damages alleging that A was driving the Nash. A notifies the company of the accident, furnishes it a copy of the petition, and explains to it that the car actually involved in the accident was the Ford and not the Nash. The company shuts its eyes to the information given to it by A as to the car actually involved in the accident, relies solely upon the allegations of the petition, makes no investigation of the facts and circumstances, denies liability and refuses to defend except upon a nonwaiver which A declines to give. A undertakes the defense of the action with counsel of his own and negotiates a prudent settlement for a stipulated sum which he pays, and then makes demand upon the company to reimburse him which it declines to do, taking the position that there is no coverage as reflected by the allegations of the petition.

*Id.* at 299-300.

The court concluded: "The hypothetical case appropriately illustrates with emphasis the scope and effect of the contention of the company. Upon further consideration, we think the contention [of the insurer that its duty was determined by the allegations alone] must fail." *Id.* at 300.

225. Cf. *Capoferri v. Allstate Ins. Co.*, 322 So. 2d 625 (Fla. 3d DCA 1975); *supra* notes 51-56 and accompanying text. In *Capoferri* an investigation revealed the *possibility* that the claim was covered. Consequently, the insurer should have defended.

226. For example, the question may arise whether the injured party is actually an employee or an independent contractor. See generally cases cited *supra* note 221.

227. The applicability of an exclusion may depend, for example, on whether or not the insured's automobile was covered.

228. See *supra* note 222.

fact. *Commercial Union Insurance Co. v. Henshall*<sup>229</sup> illustrates the latter possibility. In *Henshall* the insurer brought a declaratory judgment action to determine its obligations under a homeowner policy to defend a tort action against the insured. Dr. Alstadt, the plaintiff, alleged that while he was a business invitee on the insured's premises, he injured himself when he fell over a wire fence. The insured's policy covered injuries resulting from an "occurrence,"<sup>230</sup> but excluded injuries arising from a business pursuit.<sup>231</sup>

The evidence in the declaratory judgment action revealed that Alstadt recorded some music at the insured's studio, but inadvertently left his music at the studio after the recording session. Alstadt returned to the studio later to retrieve his music. Noticing that the studio was locked, Alstadt proceeded to the insured's house nearby. Somewhere between the studio and the house, Alstadt fell. Relying on the exclusive pleading test, the insurer refused to defend since the plaintiff alleged that the fence was on the business premises.<sup>232</sup> The Supreme Court of Arkansas held that the exclusive pleading test was not applicable because a simple investigation of the property, coupled with the insured's statement, would have raised questions regarding Alstadt's true status and his activities.<sup>233</sup> The court stated that the insurer "may not close its eyes to facts it knew or should have known, because they were easily ascertainable,"<sup>234</sup> and held that the insurer breached its duty to defend.<sup>235</sup> The insurer must therefore defend even when its investi-

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229. 262 Ark. 117, 553 S.W.2d 274 (1977).

230. See *supra* note 1.

231. 262 Ark. at 120, 553 S.W.2d at 275-76.

232. The evidence showed that Dr. Alstadt probably fell over a fence located close to the house. The testimony indicated that the insured used the fence to house his dog. The plaintiff did not allege, however, that the fence was connected with a "business pursuit." *Id.* at 120-22, 553 S.W.2d at 276-77.

233. Dr. Alstadt came to the premises after business hours to retrieve a forgotten article and it is quite likely that his injuries occurred, not on the part of the premises devoted to business pursuits, but on the premises of [the insureds'] home and that both his "activities," and whatever "activities" of [the insureds] are relied upon as negligent acts or omission, are ordinarily incident to nonbusiness pursuits.

*Id.* at 121-22, 553 S.W.2d at 276.

234. *Id.*; see also *Shepard Marine Constr. Co. v. Maryland Casualty Co.*, 73 Mich. App. 62, 250 N.W.2d 541 (1976) (investigation would have revealed that, contrary to the allegations, the damage occurred *after* operations were completed); *City of Palmyra v. Western Casualty & Sur. Co.*, 477 S.W.2d 428 (Mo. Ct. App. 1972) (investigation would have disclosed that, despite allegations to the contrary, the tractor was operated solely for locomotion, which was within the policy's coverage).

235. This decision supports the proposition that when the allegations expressly exclude coverage but the true facts indicate the *possibility* of coverage, the insurer must defend. In

gation does not decisively demonstrate coverage, if the discovered facts show the *possibility* of coverage.<sup>236</sup>

## 2. CONFLICT OF INTERESTS

A conflict of interest may exist if the insurer must defend a suit that alleges events falling under an exclusion when the known or discoverable facts show potential coverage.<sup>237</sup> Since the duty to indemnify is always based on the facts established at trial, the interests of the insurer and the insured obviously diverge. The insured would prefer that its liability be limited to negligence, which the policy covers and against which the insurer has a duty to indemnify. The insurer, on the other hand, would benefit if liability were imposed on the basis of an excluded intentional injury, which would negate the duty to indemnify. The insurer argues, therefore, that one cannot expect, nor require, the insurer to defend the insured in this situation and maintain the requisite fidelity.

The great majority of courts that have faced this apparent dilemma of the insurer hold that a conflict of interest, by itself, will not excuse an insurer from its primary contractual obligation of defending its insured.<sup>238</sup> They conclude that the conflict of interest

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*Henshall* the insurer understandably refused to defend because the complaint alleged that the plaintiff was a "business invitee," and the unpleaded objective facts indicated that the plaintiff's injuries could have resulted from the insured's business pursuits. According to the court, the duty to defend attached because the facts before the court suggested a possibility of coverage, not because the established facts definitively indicated coverage. Indeed, the court refused to decide that a duty to indemnify existed, postponing that question until after the completion of the underlying trial. As the court concluded:

We do not yet know whether the portion of the fence Dr. Alstadt fell over was the one connected to the home and there was no evidence that the other parts of the fence served the same purpose as the part referred to in the deposition. The facts have not been fully developed and will not be until the personal injury action is tried. However, appellees did present a *prima facie* case of coverage from which the duty to defend resulted.

262 Ark. at 123-24, 553 S.W.2d at 277.

236. *But see* *Harbin v. Assurance Co. of Am.*, 308 F.2d 748 (10th Cir. 1962); *supra* note 222.

237. The conflict of interest theory is equally applicable when the complaint contains allegations partially within and outside coverage, and when the complaint alleges an intentional injury exclusion and the actual facts are not established. *See, e.g.*, *Howard v. Russell Stover Candies, Inc.*, 649 F.2d 620 (8th Cir. 1981) (applying Missouri law) (conflict of interest did not relieve insurer of duty to defend against complaint alleging claims within and outside policy's coverage provisions).

238. *See, e.g.*, *Bituminous Fire & Marine Ins. Co. v. Izzy Rosen's, Inc.*, 493 F.2d 257 (6th Cir. 1974); *Babcock & Wilcox Co. v. Parsons Corp.*, 430 F.2d 531 (8th Cir. 1970); *Steyer v. Westvaco Corp.*, 450 F. Supp. 384 (D. Md. 1978); *Burd v. Sussex Mut. Ins. Co.*, 56 N.J. 383, 267 A.2d 7 (1970); *American Employers' Ins. Co. v. Continental Casualty Co.*, 85 N.M. 346, 512 P.2d 674 (1973); *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 771, 240 A.2d 397

contention is without merit in view of the express promise to defend a suit alleging a covered event, even if groundless, false, or fraudulent.<sup>239</sup> These courts, as well as commentators,<sup>240</sup> note the existence of alternatives that can ameliorate the apparent conflict between the insurer and the insured.<sup>241</sup>

**F. SITUATION 6: *The allegations and the actual facts conflict. The allegations trigger coverage; the actual facts activate an exclusion or show noncoverage.***

Situation (6) is the converse of situation (5). The question thus becomes: If the factual test establishes a duty to defend when known or discoverable facts show coverage, contrary to the allegations of the complaint, should this test also apply to negate a duty to defend when the allegations show coverage but the actual facts indicate noncoverage or an exclusion? Or stated differently, when a variance exists between the alleged and actual facts, should the factual test always control the determination of the duty to defend?<sup>242</sup>

At first glance, logic and uniformity of application would seemingly dictate using the factual test in both settings. Yet, the majority of courts examining the question have held that when the complaint indicates coverage, the insurer must defend despite its knowledge of contrary facts suggesting noncoverage or an exclusion.<sup>243</sup> In applying the exclusive pleading test in situation (6),

(1968).

239. See cases cited *supra* note 238. *Contra Williams v. Farmers Mut.*, 245 Or. 557, 423 P.2d 518 (1967) (conflict of interest eliminated insurer's duty to defend).

240. See generally *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 771, 240 A.2d 397 (1968); Comment, *supra* note 13; Note, *Use of the Declaratory Judgment to Determine a Liability Insurer's Duty to Defend—Conflict of Interests*, 41 IND. L.J. 87 (1965).

241. If a conflict exists, for example, the insurer may be required to provide its insured with independent counsel and pay the reasonable costs of defense. See *Howard v. Russell Stover Candies, Inc.*, 649 F.2d 620 (8th Cir. 1981).

242. Some courts argue that there is a significant distinction between situations (5) and (6). See *Afcan v. Mutual Fire, Marine & Inland Ins. Co.*, 595 P.2d 638 (Alaska 1979); *infra* notes 245-58 and accompanying text.

243. The following cases recognize that when the complaint alleges a covered event, but the actual facts known to the insurer exclude coverage, the insurer must still defend: *Colton v. Swain*, 527 F.2d 296 (7th Cir. 1975) (dictum) (applying Illinois law); *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949); *United Servs. Auto Ass'n v. Glens Falls Ins. Co.*, 429 F. Supp. 101 (D. Conn. 1976); *Patterson v. American Mut. Liab. Ins. Co.*, 304 F. Supp. 1088 (D. Conn. 1969); *Afcan v. Mutual Fire, Marine & Inland Ins. Co.*, 595 P.2d 638 (Alaska 1979); *Missionaries of the Co. of Mary, Inc. v. Aetna Casualty & Sur. Co.*, 155 Conn. 104, 230 A.2d 21 (1967); *Loftin v. United States Fire Ins. Co.*, 106 Ga. App. 287, 127 S.E.2d 53 (1962) (dictum); *Thornton v. Paul*, 74 Ill. 2d 132, 384 N.E.2d 335 (1978); *Aetna Ins. Co. v.*



rather than the factual test, some of these courts base their decisions upon a significant distinction between fact situations (5) and (6).<sup>244</sup> In *Afcán v. Mutual Fire, Marine & Inland Insurance Co.*,<sup>245</sup> the Supreme Court of Alaska addressed the question whether the factual test should apply equally in situations (5) and (6). The insurer had argued that Alaska case law<sup>246</sup> supported the proposition that when a complaint alleges facts within an exclusion, the factual test applies and requires the insurer to defend if it is notified or learns through its own investigation that the claim is actually covered.<sup>247</sup> From this the insurer argued that once the allegations conflict with the known or ascertainable facts, the allegations no longer control and are irrelevant in determining the existence of the duty to defend.<sup>248</sup> After its investigation the insurer in *Afcán*

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Janson, 60 Ill. App. 3d 975, 377 N.E.2d 296 (1978); *American Policyholders' Ins. Co. v. Cumberland Cold Storage Co.*, 373 A.2d 247 (Me. 1977); *Dochod v. Central Mut. Ins. Co.*, 81 Mich. App. 63, 264 N.W.2d 122 (1978); *Albany Truck Rental Serv. v. New Hampshire Merchants Ins. Co.*, 75 A.D.2d 426, 430 N.Y.S.2d 158 (1980); *Employers' Fire Ins. Co. v. Beals*, 103 R.I. 771, 240 A.2d 397 (1968). *Contra* *Kepner v. Western Fire Ins. Co.*, 109 Ariz. 329, 509 P.2d 222 (1973); *Guidry v. Zeringue*, 379 So. 2d 813 (La. Ct. App. 1980); *Farmers & Merchants State Bank v. St. Paul Fire & Marine Ins. Co.*, 309 Minn. 14, 242 N.W.2d 840 (1976); *Marshall's U.S. Auto Supply v. Maryland Casualty Co.*, 354 Mo. 455, 189 S.W.2d 529 (1945).

244. See, e.g., *Afcán v. Mutual Fire, Marine & Inland Ins. Co.*, 595 P.2d 638 (Alaska 1979); *Missionaries of the Co. of Mary, Inc. v. Aetna Casualty & Sur. Co.*, 155 Conn. 104, 230 A.2d 21 (1967); *infra* notes 252-53 and accompanying text.

245. 595 P.2d 638 (Alaska 1979).

246. *National Indem. Co. v. Flesher*, 469 P.2d 360 (Alaska 1970).

247. 595 P.2d at 644. This factual possibility is, of course, fact situation (5).

248. See, e.g., *Kepner v. Western Fire Ins. Co.*, 109 Ariz. 329, 509 P.2d 222 (1973); *Farmers & Merchants State Bank v. St. Paul Fire & Marine Ins. Co.*, 309 Minn. 14, 242 N.W.2d 840 (1976).

This argument was also attempted in *Missionaries of the Co. of Mary, Inc. v. Aetna Casualty & Sur. Co.*, 155 Conn. 104, 230 A.2d 21 (1967). The insured, a monastery, was sued for negligence after a delivery truck driver fell into a ditch on the monastery's property. The policy covered hazards from "[t]he ownership, maintenance or use of the premises, and all operations necessary or incidental thereto." *Id.* at 109, 230 A.2d at 24. The policy excluded injuries resulting from structural alterations to the premises by the insured or any contractor. The insurer discovered facts that indicated the insured had contracted with a company to build an addition to the monastery. The insured had engaged another contractor to change the existing overloaded electrical system. This work required the digging of the ditch that caused the injury.

The injured plaintiff sued the insured for negligence but did not include the facts about the new addition. According to the complaint, the injury appeared to result from operations incidental to the maintenance of the premises. The insurer argued that the actual facts indicating an exclusion excused it from defending the suit. Rejecting this contention, the court concluded:

This is a misapplication of the rule . . . requiring an insurer to conduct a reasonable investigation before refusing to defend a case in which the third party complaint, on its face, states facts which appear to bring the case outside the

had determined that the actual facts showed noncoverage.<sup>249</sup>

The Supreme Court of Alaska rejected the insurer's argument and held that once the complaint establishes a duty to defend, the insurer cannot escape its defense obligation by looking to extrinsic facts.<sup>250</sup> In situation (6), therefore, the exclusive pleading test would apply and require the insurer to defend the suit. The court reconciled the apparent conflict in Alaska law in fact situations (5) and (6) by distinguishing the two situations.<sup>251</sup> In situation (5) the application of the factual test has an *inclusionary* result, i.e., the factual test supports coverage and thus a duty to defend. In situation (6) the application of the factual test has an *exclusionary* result, which enables an insurer to evade an otherwise valid obligation to defend.<sup>252</sup> One could argue that since the court decided the exclusive pleading test should apply in situation (6), it favored the inclusionary result that establishes the insurer's duty to defend.<sup>253</sup>

coverage of the policy. The defendant's attempt to invoke the rule where, as in this case, [the] complaint appears to state facts which bring the case within the policy coverage is unsound.

*Id.* at 111, 230 A.2d at 25 (citation omitted).

249. 595 P.2d at 642.

250. *Id.* at 645.

251. The court explained the distinction in the following manner:

This holding does not conflict with our decision in *National Indemnity Co. v. Flesher*, 469 P.2d 360 (Alaska 1970), because the rule we are applying in this case—that the pleadings control—applies only in those instances where the complaint alleges a claim *within* the coverage of the policy. In *Flesher* we held that the pleadings are *not* controlling where the complaint alleges a claim *not* within the policy . . . . We believe there is a significant distinction between the two situations—[fact situation (6)] where the complaint states a claim *within* the policy but the facts indicate there is no coverage, and [fact situation (5)] where the complaint states a claim *outside* the policy but the facts indicate the claim is actually covered.

*Id.* at 645-46 (emphasis in original).

252. *Id.* at 646 n.3. Thus, if the insurer must defend under situation (5), when the allegations indicate an exclusion but the known or ascertainable contrary facts show coverage, the factual test has an *inclusionary* effect. If, however, the insurer is *relieved* of its duty in situation (6), when the complaint states a claim within the policy but the facts indicate there is no coverage, the factual test has an *exclusionary* effect. The *Afcan* court quoted Professor Keeton's suggestion:

[A]s an *inclusionary* test, this standard (the nature of the claim against the insured) is . . . consistent with the weight of authority. Quite clearly, however, it is not reliable as an *exclusionary* standard. That is, it cannot be relied upon as the basis for answering a number of questions that may be raised by an insurer's contention that it has no duty to defend because the victim alleges only a claim against the insured that falls outside the scope of the insuring agreements.

*Id.* (emphasis in original) (quoting R. KEETON, BASIC TEXT ON INSURANCE LAW § 7.6(a), at 464 (1971)).

253. 595 P.2d at 645-46.

Although the *Afcan* court did not reveal why the distinction between these factual situations warranted the different results in the selection of the relevant test, there are at least two reasons supporting the court's distinction. First, the insurance contract should govern the rights of the parties unless it is silent as to its applicability in a given situation. In situation (5) the complaint indicates an exclusion while the actual facts trigger coverage. It is clear that the policy language—the insurer will defend any alleged covered claim, even if the allegations are groundless, false, or fraudulent—does not refer at all to the situation in which the complaint falsely alleges an excluded claim. The contract is therefore silent as to the parties' rights under situation (5). This permits the court to adopt the factual test in determining whether a duty to defend exists.<sup>254</sup> In situation (6), however, the allegations present a covered claim while the actual facts indicate an exclusion. Since the language of the contract expressly obligates the insurer to defend this type of complaint regardless of the allegation's veracity, the court must apply the contractually mandated exclusive pleading test and find a duty to defend.<sup>255</sup>

Second, as noted earlier,<sup>256</sup> courts narrowly construe exclusionary provisions in order to sustain coverage whenever possible. Many courts have extended this principle to provide that unless the exclusion clearly appears on the face of the complaint, the court will not relieve the insurer from its defense obligation.<sup>257</sup> Since the exclusion in situation (6) does not appear on the face of the complaint, the court will apply the exclusive pleading test as

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254. See *supra* text accompanying notes 198-205.

255. This view is rooted in a broad holding of *Lee v. Aetna Casualty & Sur. Co.*, 178 F.2d 750 (2d Cir. 1949), in which Judge Learned Hand suggested that the language of the duty to defend provision means:

the insurer will defend the suit, if the injured party states a claim, which, qua claim, is for an injury "covered" by the policy; it is the claim which determines the insurer's duty to defend; and *it is irrelevant that the insurer may get information from the insured, or from any one else, which indicates, or even demonstrates, that the injury is not in fact "covered."*

*Id.* at 751 (emphasis added).

Thus, if a complaint alleges intentional and negligent acts, and the insured *admits* to the insurer that he acted intentionally, the insurer still must defend, although it may not have to indemnify. See *Dochod v. Central Mut. Ins. Co.*, 81 Mich. App. 63, 264 N.W.2d 122 (1978); *Michigan Miller Mut. Ins. Co. v. Christopher*, 66 A.D.2d 148, 413 N.Y.S.2d 264 (1979); *cf. Aetna Ins. Co. v. Janson*, 60 Ill. App. 3d 957, 377 N.E.2d 296 (1978) (insured's admission that he committed arson did not absolve insurer of duty to defend against complaint containing alternative theories of recovery, one of which was within policy coverage).

256. See *supra* notes 188-96 and accompanying text.

257. See *supra* note 195.

both the contract's language and the insured's reasonable expectations require.<sup>258</sup>

The minority of courts that excuse an insurer from defending when the actual facts disclose noncoverage or a policy exclusion apparently disregards the language of the insurance defense provision. These courts perceive no difference, or attribute no significance to the difference, between the factual test's inclusionary effect in situation (5) and its exclusionary effect in situation (6). *Kepner v. Western Fire Insurance Co.*<sup>259</sup> exemplifies the test's exclusionary effect. In *Kepner* the insured possessed a homeowner's policy that covered injuries sustained on the premises, but expressly excluded injuries arising from the insured's business pursuits.<sup>260</sup> While converting the insured's carport into an office for his pool service business, an employee injured the insured's grandson. The complaint against the insured failed to mention that the injury occurred during a business activity, the building of the office. Relying upon the exclusive pleading test, the insured argued that because the complaint indicated coverage (or at least did not unambiguously exclude coverage), the insurer had a duty to defend notwithstanding the actual facts.

The Supreme Court of Arizona rejected the insured's position, holding that when the allegations ostensibly indicate coverage, but the actual facts negate coverage, the insurer has no absolute duty to defend. The court reasoned:

First, under modern practices, such as the Federal Rules of Civil Procedure, followed in Arizona, the complaint serves a notice function and is framed before discovery proceedings crystallize the facts of the case. The trial focuses on the facts as they exist rather than on facts which might exist under the theory of recovery in the complaint. Accordingly, the duty to defend should focus upon the facts rather than upon the allegations of

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258. See *National Indem. Co. v. Flesher*, 469 P.2d 360 (Alaska 1970):

We believe that the rule of *Theodore* [the exclusive pleading test] is sound and should be adhered to where the third party's allegations allege facts within policy coverage despite the insurer's knowledge of facts disclosing a claim outside policy coverage. In this situation *Theodore* comports with the reasonable expectations of the insured as to the defense that will be provided because it is clear that the insurer has promised to defend any suit alleging a claim within the coverage of the policy even if such suit is "groundless, false, or fraudulent."

*Id.* at 365 (emphasis added).

259. 109 Ariz. 329, 509 P.2d 222 (1973); see also *Farmers & Merchants State Bank v. St. Paul Fire & Marine Ins. Co.*, 309 Minn. 14, 242 N.W.2d 840 (1976).

260. 109 Ariz. at 330, 509 P.2d at 223.

the complaint which may or may not control the ultimate determination of liability.<sup>261</sup>

The logic of the Supreme Court of Arizona's decision is deficient for two reasons. First, the court completely disregarded the language of the duty to defend clause.<sup>262</sup> Second, the decision<sup>263</sup> effectively bases both the duty to defend and the duty to indemnify on the actual facts; this violates the axiomatic principle that the duty to defend is distinct from and broader than the duty to indemnify.<sup>264</sup>

Under fact situation (6), then, if a variance exists between the

261. *Id.* at 331, 509 P.2d at 224.

262. *See supra* note 2 and accompanying text.

263. Unfortunately, the court was faced with obvious collusion between the third-party plaintiff and the insured. The court might not have considered the factual test had there been no relationship between the injured plaintiff and the insured.

264. The cases in the minority that apply the factual test in situation (6) involve the *identity* of the putative insured, rather than the risk coverage provided by the policy. The question raised in these cases is whether the false allegation that the defendant is an "insured" will control and trigger a defense obligation, when the party actually is not an insured under the policy's terms. In *Williams v. Community Drive-In Theatre*, 3 Kan. App. 2d 352, 595 P.2d 724 (1979), the insured's employee shot the plaintiff. The plaintiff sued both the employee and the insured, alleging that the employee was acting within the scope of her employment. The insurance policy extended coverage to employees as "omnibus insureds" only if the employee acted within the scope of employment. At trial the jury found that the employee had not acted within the scope of her employment. Consequently, the insurer refused to defend.

The plaintiff, now a judgment creditor of the defendant-employee, argued that the exclusive pleading test should apply. Since the plaintiff had alleged that the defendant was acting within the scope of her employment, she was therefore an "insured" under the policy. Accordingly, the insurer had breached its duty to defend. The court disagreed, however, stating that the insurer had no obligation to defend a stranger to the contract "merely because the plaintiff alleges that the defendant is an insured or alleges facts which, if true, would make him an insured." *Id.* at 355, 595 P.2d at 726. The court reasoned that before the duty to defend clause could apply, the plaintiff must prove *as a matter of fact* that the defendant is an insured. *See also Navajo Freight Lines v. Liberty Mut. Ins. Co.*, 12 Ariz. App. 424, 471 P.2d 309 (1970) (insurer had no duty to defend against complaint alleging that defendant was driving with permission of insured when *in fact* defendant had no such permission). The *Navajo* court stated that:

these contractual provisions do not purport to obligate the insurer to defend a complete stranger to the contract. A *sine qua non* to the existence of any obligation to defend, or pay, whether the suit be groundless or otherwise, is the pre-existing relationship of insurer-insured. *The creation of this basic relationship cannot be left to the imagination of the drafter of a complaint.*

*Id.* at 430, 471 P.2d at 315 (emphasis added); *Auto-Owners Ins. Co. v. Jones*, 397 So. 2d 317 (Fla. 4th DCA 1981) (based on exclusive pleading test, allegations in complaint failed to support finding that plaintiff was an "insured" under her husband's policy; insurer therefore had no duty to defend). *But see American Home Assurance Co. v. Czarniecki*, 255 La. 251, 230 So. 2d 253 (1970); *Lumbermens Mut. Casualty Co. v. Rollings*, 355 So. 2d 1041 (La. Ct. App. 1978).

alleged facts indicating coverage and the true facts showing non-coverage or an exclusion, the better-reasoned approach requires the insurer to defend on the basis of the exclusive pleading test. Under this fact pattern the contractual language binding the insurer to defend a complaint alleging covered claims, even if groundless, false, or fraudulent, controls the rights of the parties.

## VII. CONCLUSION: A SYNTHESIS

The exclusive pleading test—the traditional rule—no longer serves as the universal standard for determining the existence of the insurer's duty to defend. Indeed, the modern trend of authority no longer characterizes the factual test as the mere "exception" to the rule. As a result, courts that apply the exclusive pleading test automatically in all situations are taking a parochial, if not altogether unjustifiable, approach.

As presently worded, the duty to defend clause does not and cannot cover all of the factual possibilities that arise. The modern and better approach analyzes the duty to defend by determining first the fact pattern into which the case falls, and then applying the test that is most appropriate under the circumstances. This is not to suggest, however, that courts should disregard the defense provision of the insurance contract. On the contrary, the contract is dispositive of the duty to defend issue, and establishes that the exclusive pleading test shall apply, in fact situations (1) and (6).<sup>265</sup>

But as to fact situations (2), (3), (4), and (5),<sup>266</sup> the contract is silent, or at least ambiguous, with respect to the rights of the parties. Under these fact patterns the court should require the insurer to defend if the insurer knows, or could reasonably ascertain, facts that indicate a potentially covered claim. Under these circumstances the insurer should investigate and assume the defense if the claim is actually, or potentially, within the policy's coverage. The court, therefore, should not hesitate to effect an extracontractual construction by applying the factual test in order to avoid the unfairness resulting from the mechanical application of the traditional rule. If this result seems unfair, the insurer has an alternative: it can rewrite the duty to defend provision in its contract.

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265. See *supra* note 123 and accompanying text.

266. *Id.*