

# CLASSIC INSURANCE LAW IN A POSTMODERN WORLD

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"I take judge-made law as one of the realities of life."

—Benjamin Cardozo<sup>1</sup>

In 1966, Justice Mathew Tobriner wrote the opinion in the celebrated *Gray v. Zurich Insurance Co.* case.<sup>2</sup> Justice Tobriner was by that time a recognized and influential jurist of national repute. Known throughout his tenure as a judicial activist, Justice Tobriner believed that legal decisions should adapt to changing attitudes and mores of a modern society.<sup>3</sup> Justice Tobriner's legal opinions were therefore consistently designed to reflect current community principles and to protect the freedom of individuals within that community.<sup>4</sup>

In order to protect those individual rights within a society increasingly infused with imbalance of power, Justice Tobriner was a leader in revitalizing the early common law concept of imposing extra-contractual obligations based on the status or relationship of a quasi-public organization to a weaker party.<sup>5</sup> Justice Tobriner considered traditional contract law inadequate to protect individuals entering into agreements with large organizations and so believed extra-contractual impositions were required to maintain balance of bargaining power.<sup>6</sup>

In the area of tort law, Justice Tobriner also enlarged the concept of duty, with emphasis on the status of each of the parties and their relationship to each other.<sup>7</sup> With this expanded concept of duty for parties in a special relationship,

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I also gratefully acknowledge the diligent and able research assistance of Sara Noel and John Wells both of whom are members of the Hastings class of 2003. Their hard work and insight make this a better product.

<sup>1</sup> Cited in JOSEPH R. GRODIN, IN PURSUIT OF JUSTICE: REFLECTIONS OF A STATE SUPREME COURT JUSTICE 133 (1989).

<sup>2</sup> 419 P.2d 168 (Cal. 1966).

<sup>3</sup> Joseph R. Grodin, *Justice Tobriner: Portrait of the Judge as an Artist*, 29 HASTINGS L.J. 7, 9 (1977).

<sup>4</sup> *Id.* at 10.

<sup>5</sup> Peter F. Sloss & Robert G. Becker, *The Organization Affected with a Public Interest and Its Members – Justice Tobriner's Contribution to Evolving Common Law Doctrine*, 29 HASTINGS L.J. 99, 102 (1977).

<sup>6</sup> *Id.*

<sup>7</sup> Ellis J. Horvitz, *Justice Tobriner's Tort Decisions: A Reaffirmation of the Common Law Process*, 29 HASTINGS L.J. 167, 168 (1977).

Justice Tobriner encouraged greater sensitivity toward plaintiffs' injuries and protection of their rights.<sup>8</sup>

His opinions in cases involving real property also supported his values of economic fairness and promoted protection of consumers' reasonable expectations.<sup>9</sup> Justice Tobriner's application of these values in his decisions reflect his awareness of the socioeconomic realities of contemporary society and his belief in the need for judicial action to remedy inequity.<sup>10</sup>

The *Gray* case attracted attention immediately due to its far-reaching effects and Justice Tobriner's reputation.<sup>11</sup> Over time it has proven to be a standard by which other cases are measured.<sup>12</sup> In the pages that follow, I make the case that *Gray's* importance and lasting power is attributable to several factors. These include its simple, easily absorbed facts, and its influence on three important aspects of modern insurance law: the intentional acts exclusion with the related insurer's conflict of interest, the doctrine of reasonable expectations, and the duty to defend. While the facts were beyond Justice Tobriner's control, the eloquence of *Gray's* rhetoric was not and in it he displays the sure work of a seasoned jurist at the height of his abilities. My judgment is that the facts and the confluence of issues discussed in *Gray* argue easily for its immortality.

## I. THE FACTS

The facts of *Gray v. Zurich* are tailored to the classroom. They are simple, easily accessible, and provide a sound basis for empathy. Dr. Gray was involved in a near-miss automobile collision. The driver of the other car, John Jones, approached Gray and jerked open Gray's car door in a menacing way. Gray, using a preemptive strike theory of self-defense, struck Jones who sued for the intentional tort. Jones asked for \$50,000 in actual damages and \$50,000 in punitive damages. Gray tendered the claim and defense to Zurich. Zurich refused to defend and, at trial, Jones recovered \$6,000 in actual damages.

The insuring agreement, which is spelled out in the second full paragraph of the opinion, provides a good introduction to the case and to the intricacies of insurance law. The court notes:

<sup>8</sup> *Id.*

<sup>9</sup> Jonathan R. Adler & Richard M. Mosk, *Justice Tobriner and Real Property*, 29 HASTINGS L.J. 127, 128 (1977).

<sup>10</sup> *Id.* at 129.

<sup>11</sup> William E. Knepper, *Insurer's Duty to Defend: Recent Developments*, 17 DEFENSE L.J. 391 (1968); Donald F. Farbstein & Francis J. Stillman, *Insurance for the Commission of Intentional Torts*, 20 HASTINGS L.J. 1219 (1969); Note, *The Insurer's Duty to Defend Made Absolute: Gray v. Zurich*, 14 UCLA L. REV. 1328 (1967).

<sup>12</sup> Paula L. Harrington, *The Duty to Defend in California After Montrose Chemical Corporation v. Superior Court: Is the California Supreme Court Protecting Policyholders or Encouraging Litigation and the Early Settlement of Unworthy Claims?*, 31 CAL. W. L. REV. 165, 170 (1994) (noting the importance of *Gray v. Zurich*).

Bob Schiff, whom I acknowledge above, has often told me that he believes he could teach a semester-long insurance law course using only *Gray v. Zurich*. While I think I agree, as a teacher of insurance law, I have been reluctant to take on his tacit challenge. In the interest of full disclosure, as a casebook author I confess a pecuniary interest in not having *Gray* be the sole case in my book.

[Gray], is the named insured under an insurance policy issued by [Zurich]. A "Comprehensive Personal Liability Endorsement" in the policy states, under a paragraph designated "Coverage L," that the insurer agrees "[T]o pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage, and the 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; but the company may make such investigation and settlement of any claim or suit as it deems expedient." The policy contains a provision that "[T]his endorsement does not apply" to a series of specified exclusions set forth under separate headings, including a paragraph (c) which reads, "under coverages L and M, to bodily injury or property damages caused intentionally by or at the direction of the insured."<sup>13</sup>

This neatly captures the essence of the dispute. While Gray is ostensibly covered for any bodily injury he might cause, the coverage does not extend to bodily injury that is intentionally caused. At first glance, Zurich appears to be correct in its assessment. Indeed, the language might lead a layperson to believe that she would not receive any protection for her intentional acts. Thus, the stage is set for a classic drama. All appears lost for the hapless Dr. Gray.

## II. THE INTENTIONAL ACTS EXCLUSION

California Insurance Code Section 533 states "[a]n insurer is not liable for a loss caused by the willful act of the insured; but he is not exonerated by the negligence of the insured, or of the insured's agent or others."<sup>14</sup> The statute is based on the fundamental public policy that "[t]o allow recovery for such losses would encourage conduct which is socially undesirable because it is injurious to others . . . or simply economically wasteful."<sup>15</sup> On that basis, courts have held that an insurer cannot agree to cover acts excluded by the statute.<sup>16</sup> Thus, Dr. Gray's initial hurdle is that Section 533 of the California Insurance Code bars coverage for intentional injury.<sup>17</sup> Zurich's position was that to provide a defense in these circumstances would violate the public policy of not covering intentional acts.<sup>18</sup>

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<sup>13</sup> Gray v. Zurich Ins. Co., 419 P.2d 168, 170 (Cal. 1966).

<sup>14</sup> A "willful act" within the meaning of this section means something more than ordinary negligence or the mere intentional doing of an act; the existence of an intent to injure is relevant. Nuffer v. Ins. Co. of N. Am., 45 Cal. Rptr. 918, 925 (Ct. App. 1965).

<sup>15</sup> James M. Fischer, *The Exclusion From Insurance Coverage of Losses Caused by the Intentional Acts of the Insured: A Policy in Search of Justification*, 30 SANTA CLARA L. REV. 95 (1990).

<sup>16</sup> Shell Oil Co. v. Winterthur Swiss Ins. Co., 15 Cal. Rptr. 2d 815, 830-31 (1993).

<sup>17</sup> Gary L. Fontana & Anthony J. Barron, *Insurance Coverage for Intentional Acts*, 658 PLI/Comm. 203 (1993) (providing an overview of insurance coverage for willful acts including the public policy rationale, the difficulty in determining the willfulness of the insured's conduct, and the conflicting jurisdictional approaches).

Dr. Gray's problem was a matter of contract. Gray, 419 P.2d at 177. Professor Robert H. Jerry observes that "after the mid-1960s it became common to find liability policies stating that coverage would not exist for [acts] intended from the standpoint of the insured." ROBERT H. JERRY, *UNDERSTANDING INSURANCE LAW*? 63C (2d ed. 1996).

<sup>18</sup> Gray, 419 P.2d at 177.

The intentional acts exclusion makes sense. With the exclusion memorialized in a statute, in the contract, and in the case law, Dr. Gray's position seemed bleak. However, in the time leading up to *Gray v. Zurich*, California case law had laid a small foundation that, in at least two instances, the courts had avoided the exclusion.<sup>19</sup> In 1955, *Arenson v. National Auto & Casualty Insurance Co.* held that the exclusion did "not preclude an insured who has not participated in an intentional injury from being indemnified against liability for an injury intentionally caused by another insured."<sup>20</sup> In another opinion by Justice Tobriner, *Tomerlin v. Canadian Indemnity*, the California Supreme Court held that:

[a]lthough an insurer may not indemnify against liability caused by the insured's willful wrong, defendant's liability here does not arise from a contract executed prior to plaintiff's willful misconduct, but from an *estoppel* which arose after it. . . . Recovery under a subsequent estoppel does not offend such public policy [discouraging intentional acts]. "It [does] not tend to encourage unlawful conduct. It [does] not arouse an illegal temptation."<sup>21</sup>

*Gray v. Zurich* was not so limited or timid in approach. The court noted that an insurance policy imposes dual obligations on an insurer. The first is a duty to indemnify against loss; the second is a duty to defend.<sup>22</sup> Justice Tobriner's innovation was to limit the public policy prohibition to indemnity only, reasoning that otherwise, the basic purpose of insurance, to provide litigation protection, is defeated.<sup>23</sup> As a second rationale, Justice Tobriner observed that providing a defense does not hamper the policy of not encouraging intentional acts.<sup>24</sup>

In what is the only weak aspect of the case, *Gray v. Zurich* glosses over the conflict of interest problem that arises. Obviously, the insurer has a vested

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<sup>19</sup> Donald F. Farbstein & Francis J. Stillman, *Insurance for the Commission of Intentional Torts*, 20 HASTINGS L.J. 1219, 1222 (1969) ("Coverage for the intentional wrong of an agent was the earliest form of insurance for intentional tort liability to receive judicial recognition.").

<sup>20</sup> *Arenson v. Nat'l Auto. & Cas. Ins.*, 286 P.2d 816, 818 (Cal. 1955).

<sup>21</sup> 394 P.2d 571, 577-78 (Cal. 1964) (quoting *New Amsterdam Cas. Co. v. Jones*, 135 F.2d 191, 195) (6th Cir. 1943)) (emphasis added).

<sup>22</sup> *Gray*, 419 P.2d at 173.

<sup>23</sup> *Id.* at 177-78.

<sup>24</sup> *Id.*; see also *Bodell v. Walbrook Ins. Co.*, 119 F.3d 1141 (9th Cir. 1977) (relying on *Gray* to allow the defense of a federal criminal prosecution). Professor Willy E. Rice asserts that courts often allow their biases toward certain classes of victims influence their judgments, and that too many victims go uncompensated for their injuries because courts declare the insurer has no duty to defend. Willy E. Rice, *Insurance Contracts and Judicial Discord Over Whether Liability Insurers Must Defend Insureds' Allegedly Intentional and Immoral Conduct: A Historical and Empirical Review of Federal and State Courts' Declaratory Judgments—1900-1997*, 47 AM. U. L. REV. 1131, 1217 (1998). He proposes legislation that requires insurers to defend policyholders even when a third party complaint alleges an intentional act. *Id.* at 1218.

By contrast, Professor Susan Randall contends that the traditional complaint rule, by which the allegations of a third party's complaint determine an insurer's duty to defend an insured, poses serious problems of increased litigation, costs, and conflicts of interest of the insurer. Susan Randall, *Redefining The Insurer's Duty to Defend*, 3 CONN. INS. L.J. 221, 222-23 (1997). Professor Randall suggests that insurers should be permitted to deny defense to insureds when extrinsic facts indicate no obligation of coverage. *Id.* at 224.

interest in pursuing an intentional act theory so as to defeat coverage. In undertaking the defense of an insured, the insurer might advertently or inadvertently shape its case so that its duty to indemnify is obviated by the intentional acts exclusion. While the court seems to give this theory short shrift, the reality is that the conflict is very real.<sup>25</sup>

Despite the minor flaw, Justice Tobriner deftly removed a significant barrier to Dr. Gray's claim. Still, without more, the door to Dr. Gray's recovery was not completely open. In a significant expansion of existing case law, Justice Tobriner opens up the entire universe of insurance policy interpretation. A brief background is useful in order to fully appreciate his craftsmanship.

### III. THE DOCTRINE OF REASONABLE EXPECTATIONS

In the late 1950s, the interpretation of insurance policies in California followed a conventional approach, which centered around the principle of *contra proferentem* – contracts should be interpreted against the drafter and the uncertainty attendant to the use of imprecise language was to be held against the drafter.<sup>26</sup> That simple approach was soon to be substantially altered.

In 1962, Justice Tobriner wrote the majority opinion in *Steven v. Fidelity & Casualty Co.*<sup>27</sup> *Steven* held that an exclusionary clause in an insurance contract would not be enforced where “the public may *reasonably expect* coverage, [unless the exclusion was] conspicuous, plain and clear.”<sup>28</sup>

At the time the *Steven* opinion was issued, its reach was uncertain. The case dealt with an airline passenger who had purchased a life insurance policy from a machine located in an airport.<sup>29</sup> When the aircraft in which the insured passenger was flying crashed, the insurer attempted to avoid payment to the policy's beneficiaries on the basis of an exclusion that purported to exclude flights on “unscheduled carriers.”<sup>30</sup> While the decision could have rested on the ambiguous and arcane nature of the exclusion alone, Justice Tobriner went beyond the bounds of the traditional *contra proferentem* principle. According to one commentator, “the emphasis throughout the [*Steven*] opinion upon the reasonable expectations of the weaker party . . . suggests that some sort of larger principle is at work.”<sup>31</sup>

*Steven* was revolutionary in its own right.<sup>32</sup> Still, unsurprisingly, it did not attract significant attention. Machine sold insurance policies were a narrow

<sup>25</sup> See, e.g., *San Diego Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*, 208 Cal. Rptr. 494 (1984) (requiring the appointment of independent counsel in the case of conflicts); CAL. CIV. CODE § 2860 (2001) (outlining parameters of the appointment of independent counsel).

<sup>26</sup> *Cont'l Cas. Co. v. Phoenix Constr. Co.*, 296 P.2d 801, 809 (Cal. 1956).

<sup>27</sup> 377 P.2d 284, 294 (Cal. 1962).

<sup>28</sup> *Id.* (emphasis added).

<sup>29</sup> *Id.* at 286.

<sup>30</sup> *Id.* at 290.

<sup>31</sup> Martin Kamarck, *Opening the Gate: The Steven Case and the Doctrine of Reasonable Expectations*, 29 HASTINGS L.J. 153, 161 (1977).

<sup>32</sup> Rose Elizabeth Bird, *Justice Mathew O. Tobriner – The Heart of a Lion, the Soul of a Dove*, 70 CAL. L. REV. 871 (1982) (listing *Steven* as an example of Justice Tobriner's achievements); David M. Balabanian, *Justice Was More Than His Title*, 70 CAL. L. REV. 878, 879 (1982) (calling the decision “near scandalous” in its time).

niche of the insurance industry, aircraft crashes were relatively rare, and the facts (the insured's inability to read the policy before it was deposited in the mail) suggested that *Steven* would be relegated to the arcana of insurance law. *Gray v. Zurich* changed this view.

Here, *Gray v. Zurich* is straightforward, covering the basic principles. First, the insurance contract is one of adhesion and exclusions are interpreted narrowly. Second, Justice Tobriner, relying on his earlier opinion in *Steven*, stated that the doctrine of "reasonable expectations" makes the inconspicuous, unclear provision hard to enforce.<sup>33</sup> While the application of the reasonable expectations doctrine in *Gray v. Zurich* flowed naturally from *Steven*, the stakes had changed. The doctrine now applied in a wide area and the scope of the doctrine had been expanded far beyond the narrow facts of *Steven*.<sup>34</sup>

Dr. Gray's dilemma was that the face of Jones' complaint did not bring Gray's claim within the scope of coverage because of the intentional acts exclusion. After having established that the intentional acts exclusion did not necessarily bar coverage, Justice Tobriner's differentiations of the insurer's dual duties to indemnify and to defend were key.

First, Justice Tobriner noted that because the result of any case was difficult to predict, the promise to defend subject to any exclusion was inherently ambiguous.<sup>35</sup> He stated:

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<sup>33</sup> According to *Steven* an exclusionary clause in an insurance policy is not enforceable where "the public may reasonably expect coverage, [unless that clause is] conspicuous, plain and clear." *Steven*, 377 P.2d at 294.

Professor Robert H. Jerry explores the development of the doctrine of reasonable expectations within insurance law, beginning with Judge Keeton's 1970 *Harvard Law Review* article, which identified the principle that reasonable expectations of insureds should be recognized. Robert H. Jerry, *Insurance, Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21, 22-23 (1998). The doctrine of reasonable expectations protects the weaker party in a contract transaction by charging insurers with a duty to honor the insured's reasonable expectations. Professor Jerry concludes that the doctrine should apply not only to insurance law, but to contract law principles in general. *Id.* at 55-57.

<sup>34</sup> Fischer, *supra* note 15, at 105.

<sup>35</sup> *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 173 (Cal. 1966). One commentator provides a gloss on this area by describing Florida's experience.

In Florida, the insurer's duties are not coextensive. The duty to defend is generally considered to be both broader and more difficult to determine than the duty to indemnify. The traditional explanation for this difference has been timing. Whereas the duty to indemnify is determined after the facts have been established, the duty to defend is determined at the commencement of the lawsuit, before the facts have been established.

Gregor J. Schwinghammer, Jr., *Insurance Litigation in Florida: Declaratory Judgments and the Duty to Defend*, 50 U. MIAMI L. REV. 945, 948 (1996).

Florida purports to follow the "exclusive pleading" test, whereby an insurer's duty to defend arises from the allegations in the complaint. Under Florida law, the duty to defend is "distinct from and broader than" the duty to indemnify. If a complaint alleges some claims, which are within coverage, and some claims outside of coverage, the question of defense must be resolved in favor of the insured, and the insurer must provide a defense for the entire action.

*Id.* at 950.

Many courts have allowed a declaration regarding the duty to defend, but have required that a declaration regarding the duty to indemnify must wait until the parties determine liability. . . . If the trial court determines that [the insurer] has no duty to defend, the issues of whether [the insurer] has a duty to indemnify [the insured] will be moot. On the other hand, if [the insurer]

No one can determine whether the third party suit does or does not fall within the indemnification coverage of the policy until that suit is resolved . . . . [Thus, t]he carrier's obligation to indemnify inevitably will not be defined until the adjudication of the very action which it should have defended. Hence the policy contains its own seeds of uncertainty; the insurer has held out a promise that by its very nature is ambiguous.<sup>36</sup>

While the policy could have clarified the point, it did not do so. Moreover, Justice Tobriner observed that the policy contains a promise to defend even baseless suits.<sup>37</sup> Thus, the insured could have reasonably believed the insurer would defend the case.

Justice Tobriner bolstered the argument by pointing out that even if Dr. Gray intended harm, his intention may have caused unintended harm.<sup>38</sup> Justice Tobriner summed up by saying "[t]he insured is unhappily surrounded by concentric circles of uncertainty."<sup>39</sup> Accordingly, the insurer must defend if the potential for coverage exists under the policy.<sup>40</sup>

While Zurich conceded the general rule that a wrongful failure to defend results in liability for the judgment, it argued the judgment was based on a matter not within coverage. The response to Zurich's argument was curt. According to the court, if this were the rule the insured would face an impossible burden of proving the extent of the loss caused by the insurer's breach.<sup>41</sup> Moreover, Zurich was chastised for attempting to whittle down its obligation and pursuing that cause through the courts.<sup>42</sup>

Finally, Justice Tobriner responded to the anticipated criticism that the case makes everything subject to the duty to defend. He stated that the duty to defend applies to all claims only if they fall within the scope of coverage.<sup>43</sup> Zurich, according to Justice Tobriner, "cannot construct a formal fortress of the third party's pleadings and retreat behind its walls. . . . [C]ourts do not examine only the pleaded word but the potential liability created by the suit."<sup>44</sup> Pleadings are "malleable, changeable and amendable."<sup>45</sup> The allegedly injured third party makes a poor arbiter of coverage.

*Gray v. Zurich* continues to make its presence known. In 1993, the California Supreme Court in *Montrose Chemical Corp. of California v. Superior Court* had occasion to address the doctrine of reasonable expectations in the context of massive CERCLA litigation.<sup>46</sup> Montrose Chemical Corp. produced DDT at a Southern California location from 1947 to 1982. The federal govern-

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has a duty to defend, then any determination as to its duty to indemnify should be deferred until the issue of [the insured's] liability is decided.

*Id.* at 967.

<sup>36</sup> *Steven*, 377 P.2d at 173.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* at 174.

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*; see also Fischer, *supra* note 15, at 105.

<sup>41</sup> *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 179 (Cal. 1966).

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* at 176.

<sup>44</sup> *Id.* The import of this language is discussed below; see *infra* text accompanying notes 57-60.

<sup>45</sup> *Id.*

<sup>46</sup> 861 P.2d 1153, 1154-55 (Cal. 1993).

ment ordered Montrose to participate in the cleanup of the now infamous Stringfellow disposal site and the Los Angeles Harbor. Seven carriers who wrote commercial general liability insurance coverage for Montrose over the period refused or severely limited tender of defense for various reasons, among them, that the dumpings were intentional acts.<sup>47</sup> The court held that in proceedings for summary judgment: (1) both the insured and insurer could look to facts outside the third party's complaint to determine the coverage question; (2) the insured must make a *prima facie* showing of the *potential* for coverage; and (3) the insurer must show as a matter of law that there is no coverage under the policy.<sup>48</sup> In reaching this result, the court relied on *Gray v. Zurich*, observing that California courts have been "consistently solicitous of the insureds' expectations" in connection with insurance policy interpretation.<sup>49</sup>

Stepping back, one is forced to admire Justice Tobriner's audacity. He begins with a conventional approach, he crafts a new doctrine that is apparently applicable in a narrow context, and then he applies the new doctrine in a much broader arena. Nearly thirty years after *Gray v. Zurich*, its principles find application in a multi-billion dollar environmental case in which the doctrine of reasonable expectations remains intact.<sup>50</sup> This sweeping panorama should leave even the casual observer of events with mouth agape.

#### IV. THE DUTY TO DEFEND

As discussed above, a liability insurance policy imposes two primary obligations on insurers. First, insurers have a duty to indemnify.<sup>51</sup> Second, insurers have a duty to defend.<sup>52</sup> This dual aspect of a liability insurer's undertaking can be confusing. It must be kept in mind that the duty to defend and the duty to indemnify depend on the existence of coverage.<sup>53</sup> While liability insurance policies initially required insurers to indemnify without a corresponding duty to

<sup>47</sup> *Id.* at 1155-56.

<sup>48</sup> *Id.* at 1158-60. The insurer, however, is limited to reliance on *undisputed or extrinsic facts* in making its showing so that the insured is not prejudiced by the prospect of having an adverse finding in the declaratory relief action. *Id.*

<sup>49</sup> *Id.* at 1157; Harrington, *supra* note 12, at 182.

<sup>50</sup> Professor Jeffrey W. Stempel argues that this should not be a remarkable occurrence. In his view, jurists have been unnecessarily dissuaded from use of the doctrine of reasonable expectations because of the undeserved emphasis on the "rights-at-variance" brand of the doctrine. Jeffrey W. Stempel, *Unmet Expectation: Undue Restriction of the Reasonable Expectations Approach and the Misleading Mythology of Judicial Role*, 5 *CONN. INS. L.J.* 181, 182-84 (1998). California's experience appears to validate Professor Stempel's thesis inasmuch as the doctrine has existed for more than forty-five years without much apparent harm to the fabric of insurance law.

<sup>51</sup> "[S]tandard comprehensive or commercial general liability insurance policies provide that the insurer has a duty to indemnify the insured for those sums that the insured becomes legally obligated to pay as damages for a covered claim." *Aerojet Gen. Corp. v. Transp. Indem. Co.*, 948 P.2d 909, 920 (Cal. 1997) (citing *Buss v. Superior Court*, 939 P.2d 766 (Cal. 1997)).

<sup>52</sup> "Standard comprehensive or commercial general liability insurance policies also provide that the insurer has a duty to defend the insured in any action brought against the insured seeking damages for a covered claim." *Id.* (citing *Buss*, 939 P.2d 766).

<sup>53</sup> Susan Randall, *supra* note 24, at 251; Tom Baker, *Liability Insurance Conflicts and Defense Lawyers: From Triangles to Treahedrons*, 4 *CONN. INS. L.J.* 101, 138-39 (1997).

defend, most policies also provided that insurers had a right to assume the control of a defense in order to protect its interests in litigation.<sup>54</sup> This aspect evolved into a duty to defend.<sup>55</sup>

Professor James Fischer states:

[C]ourts first defined the scope of the duty to defend in terms of the claim pleaded against the insured in the underlying action. . . . The claim alleged against the insured by the claimant determined the insurer's obligation to defend, if any, because the language of the complaint was compared with the language of the policy to determine if the claim was within the coverage provided the insured.<sup>56</sup>

This traditional reliance on the pleadings was a primary focus of *Gray v. Zurich*. *Gray* held that a “[d]efendant cannot construct a formal fortress of the third party’s pleadings and retreat behind its walls. . . . [C]ourts do not examine only the pleaded word but the *potential* liability created by the suit.”<sup>57</sup> The court’s rationale was that, “[i]n 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>58</sup> Because, the court found:

[R]estrict[ing] the defense obligation of the insurer to the precise language of the pleading would not only ignore the thrust of the cases but would create an anomaly for the insured. . . . [a]n 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>59</sup>

Justice Tobriner was also careful to note that:

[M]odern 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 for liability under the policy.<sup>60</sup>

It is clear Justice Tobriner saw *Gray v. Zurich* as harmonizing with modern pleading and that his task was to mirror that aspect of the law. Seen as such, the decision to abandon total reliance on the pleadings inevitably followed.

Freeing the determination of the duty to defend from the confines of the policy and the pleadings was extraordinary in itself. Combining this with the application of the doctrine of reasonable expectations was powerful.<sup>61</sup> The result was revolutionary.

Prior to *Gray v. Zurich*, California followed a more traditional approach.<sup>62</sup> This approach, the so-called “four corners rule” (when applied to only the pleading) or the “eight corners” rule (when applied to the pleading and to the

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<sup>54</sup> James M. Fischer, *Broadening the Insurer's Duty to Defend: How Gray v. Zurich Insurance Co. Transformed Liability Insurance into Litigation Insurance*, 25 U.C. DAVIS L. REV. 141, 146-47 (1991).

<sup>55</sup> *Id.* at 149.

<sup>56</sup> *Id.* at 151.

<sup>57</sup> *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 176 (Cal. 1966) (emphasis added).

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.* at 176-77.

<sup>61</sup> Fischer, *supra* note 54, at 156-57.

<sup>62</sup> In *Ritchie v. Anchor*, the court held that:

insurance policy), essentially is a rule of formalism. It was similar to that currently favored in Texas in which the policy language is compared to the allegations in the complaint in order to determine the scope of the duty to defend.<sup>63</sup> This approach has the advantage of intellectual convenience and is relatively easy to apply.<sup>64</sup>

However, the approach in *Gray v. Zurich* appears to enjoy acceptance in several states beyond California. Recent decisions in jurisdictions including Hawaii, Kansas, Kentucky, and Wyoming, may be characterized by a broad predisposition to find a duty to defend if there is any potential liability under the policy.<sup>65</sup>

Additionally, at least one case seems to signal that *Gray v. Zurich*'s influence has extended to Illinois.<sup>66</sup> *Associated Indemnity Co. v. Insurance Co. of North America* acknowledged the insurer's obligation to defend if a complaint stated claims covered by a policy, but pushed the boundary further by asserting that, "the insurer is obligated to conduct the putative insured's defense if the insurer has knowledge of true but unpleaded facts, which, when taken together with the complaint's allegations, indicate that the claim is within or potentially within a policy's coverage."<sup>67</sup> The *Associated Indemnity* court considered this an issue not previously resolved in Illinois, but cited authority from other jurisdictions as justification.<sup>68</sup>

Interestingly, *Gray v. Zurich* is not cited in *Associated Indemnity*, but Justice Tobriner's distinctive rhetoric is apparent. The Illinois court notes that, "[t]o 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."<sup>69</sup> The opinion goes on to discuss several issues covered by *Gray v. Zurich* including the rea-

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the insurer's obligation to defend is measured by the terms of the insurance policy and the pleading of the claimant who sues the insured. . . . [T]he complaint must be taken by its four corners and the facts arrayed in a complete pattern without regard to niceties of pleading or differentiation between different counts of a single complaint. And the ultimate question is whether the facts alleged do fairly apprise the insurer that the plaintiff is suing the insured upon an occurrence which, if his allegations are true, gives rise to liability of the insurer to insured under the terms of the policy.

286 P.2d 1000, 1003-04 (Cal. Ct. App. 1955).

<sup>63</sup> *Am. Alliance Ins. Co. v. Frito Lay Inc.*, 788 S.W.2d 152, 153 (Tex. App. 1990). Under this approach, "[t]he duty to defend is not affected by facts ascertained before suit, developed in the process of litigation, or by the ultimate outcome of the suit." *Id.* at 154. One commentator has suggested that this approach is the majority approach, and notes that other states generally applying this standard (albeit by different names) include Florida, Illinois, Minnesota, New York, Ohio, and Washington, among others. Rice, *supra* note 24, at 1152-54.

<sup>64</sup> Michael Sean Quinn & L. Kimberly Steele, *Insurance Coverage Opinions*, 36 S. TEX. L. REV. 479 (1995) (discussing insurance coverage and the Texas approach).

<sup>65</sup> Rice, *supra* note 24, at 1151.

<sup>66</sup> *Assoc. Indem. Co. v. Ins. Co. of N. Am.*, 386 N.E.2d 529 (Ill. App. Ct. 1979).

<sup>67</sup> *Id.* at 536.

<sup>68</sup> *Id.*

<sup>69</sup> *Id.* (emphasized portions apparently quoting *Gray v. Zurich Ins. Co.*, 419 P.2d 168, 176 (Cal. 1966)).

sonable expectations doctrine, exclusionary clauses, and conflicts of interest.<sup>70</sup> If not directly influenced by *Gray v. Zurich*, the decision certainly proceeded along a parallel path.

*Associated Indemnity* notwithstanding, the generally accepted rule in Illinois does not appear to have changed. A more recent decision, for example, affirms that "the duty to defend extends only to suits and not to allegations, accusations, or claims which have not been embodied within the context of a complaint."<sup>71</sup>

*Associated Indemnity* does not, however, appear to be completely without influence. In 1991 in *Fitzpatrick v. American Honda Motor Co., Inc.*, the New York Court of Appeals went beyond New York's general approach and asserted "that the insurer must provide a defense if it has knowledge of facts which potentially bring a claim within the policy's indemnity coverage."<sup>72</sup> Citing *Associated Indemnity*, the court goes on to use the same "formal fortress" language originally used by *Gray v. Zurich* to explain why exclusive reference to the third party's complaint might allow an insurer to avoid its responsibilities under the contract.<sup>73</sup> Like *Associated Indemnity*, *Fitzpatrick* does not cite *Gray v. Zurich*, but it certainly appears to have been influenced by it from at least three sources: directly from two California cases that rested on *Gray*; and somewhat less directly via *Associated Indemnity*.<sup>74</sup>

In California, *Gray v. Zurich* remains very much alive and plays a prominent part in any number of significant cases.<sup>75</sup> The principles in *Gray v. Zurich*, however, have evolved to allow insurers to use evidence outside of the complaint and the policy to demonstrate a lack of coverage. For example, the California Supreme Court in *Montrose Chemical Corp. v. Superior Court* found that "evidence extrinsic to the underlying complaint can defeat as well as generate a defense duty."<sup>76</sup> However, in order to avoid the duty to defend the court went on to emphasize that "the insurer must prove with undisputed extrinsic evidence that there is no possibility of coverage."<sup>77</sup>

Finally, *Gray* is an object lesson in jurisprudence. It is undeniable that *Gray v. Zurich* has dramatically affected the structure of defense insurance and litigation strategies within the tort system. The traditional eight corners rule is

<sup>70</sup> *Id.* at 538-42.

<sup>71</sup> *Lapham-Hickey Steel Corp. v. Prot. Mut. Ins. Co.*, 655 N.E.2d 842, 847 (Ill. 1995).

<sup>72</sup> *Fitzpatrick v. Am. Honda Motor Co.*, 575 N.E.2d 90, 92 (N.Y. 1991).

<sup>73</sup> *Id.* at 93-94.

<sup>74</sup> *Fresno Econ. Imp. Used Cars v. U.S. Fid. & Guar. Co.*, 142 Cal. Rptr. 681 (Ct. App. 1977); *Mullen v. Glen Falls Ins. Co.*, 140 Cal. Rptr. 605 (Ct. App. 1977). A brief analysis reveals that *Fitzpatrick* has been followed in several instances by New York and other courts. See *Cont'l Cas. Co. v. Rapid-Am. Corp.*, 609 N.E.2d 506 (N.Y. 1993).

<sup>75</sup> See, e.g., *Buss v. Superior Court*, 939 P.2d 766, 773-75 (Cal. 1997); *Montrose Chem. Corp. of Cal. v. Superior Court*, 861 P.2d 1153, 1157-64 (Cal. 1993); *Bank of the W. v. Superior Court*, 833 P.2d 545, 551 (Cal. 1992).

<sup>76</sup> *Montrose*, 861 P.2d at 1155.

In the same vein, Professor Susan Randall suggests that insurers should be permitted to deny defense to insureds when extrinsic facts indicate no obligation of coverage. See Randall, *supra* note 24, at 224.

<sup>77</sup> Michael A. Orlando & Megan Gabel, *The Duty to Defend: What a Difference a State Makes!*, 29 Brief 14, Summer 2000, at 16.

simply not up to the task in today's world.<sup>78</sup> New York's *Fitzpatrick* case emphasizes how much *Gray v. Zurich* was ahead of its time forty-five years ago.

## V. CONCLUSION

*Gray v. Zurich* is a classic insurance law opinion, which is destined to survive as a classroom chestnut and as a foundation of modern insurance law. First, as a teaching tool, *Gray v. Zurich* is unparalleled. It has the unique combination of simple facts and bedrock principles laid out with incomparable rhetorical flourish. Indeed, the failure of one court to cite *Gray v. Zurich* is glaring due to the unattributed use of Justice Tobriner's colorful metaphor admonishing us not to make a fortress of pleadings.<sup>79</sup>

Second, *Gray v. Zurich* is a foundation of modern insurance law. It breaks new ground in three significant areas: the intentional acts exclusion, the doctrine of reasonable expectations, and the duty to defend. While each of these areas was the subject of separate evolutions, the confluence of these principles with extensions of each in a single case was unprecedented. This combination of facts and the judicial art is rare.

It is fashionable to decry "judicial activism," and politicians are quick to voice their support for judges who will uphold the law as written.<sup>80</sup> Happily, those who are discerning know that legislatures express themselves imperfectly, that the judiciary is a separate branch of government with its own set of responsibilities, and that able judges must exercise considerable discretion on a daily basis within the context of existing norms.<sup>81</sup> How fortunate then that California had a person of Justice Tobriner's ability to guide it through the intricacies of insurance law. As a teacher of insurance law, I am amazed by the eloquence of *Gray v. Zurich* every time I teach a new class of students. If I can open my students' eyes to the shining jewel of *Gray v. Zurich*, I count the class a success.

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<sup>78</sup> Randall, *supra* note 24, at 265 (noting the lack of justification for the complaint rule and urging modification).

Professor James M. Fischer argues that the potentiality test adopted in *Gray v. Zurich* is based on public policy considerations that the duty to defend is broader than the duty to indemnify. See Fischer, *supra* note 54. He concludes that the accommodation of *Gray* is justified because it forces insurers ultimately to internalize the costs of the duty to defend. *Id.* at 182.

<sup>79</sup> Assoc. Indem. Co. v. Ins. Co. of N. Am., 386 N.E.2d 529, 536 (Ill. App. Ct. 1979).

<sup>80</sup> GRODIN, *supra* note 1, at 133 (criticizing a former U.S. Attorney General's comment that judges should not make law).

<sup>81</sup> *Id.*; ROBERT E. KEETON, JUDGING 28-30 (1990).