North Dakota Law Review

Volume 31 | Number 1 Article 5

1955

Insurance - Duty to Defend under Liability Policy

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itself from seeing it rather than imposing its idiosyncracies on others, it is hard to put the ideal into practice.

Whether the group has the direct sanction of government on any level, or is merely a social or religious pressure group, its members will think, at least subconsciously, that their own particular dogma and beliefs are correct not only for themselves, but for all society, and will act accordingly. This has been unfortunately demonstrated time and again.

Though there are certain constants in our society, many values are still relative, and opinions and mores vary at least superficially from group to group. Therefore, perhaps it would be best to look to the method adopted by the English, namely that of the advisory review board. In this country, regional review boards could be set up to inform the people of the content of a particular motion picture without editorializing. In this way, the final adjudication of the merits of the cinematic product could be made by the one most closely affected in the final analysis: the movie-goer. Children would be protected through the guidance of parents, who would themselves be kept informed by means of the regional board of review.

By some means such as this both governmental and pressure group censorship might be eliminated. Both are objectionable on the same principle. They attempt to give to the few the power to decide what is best for the many. This is essentially totalitarian, and diametrically contrary to our democratic principles of government.

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INSURANCE—DUTY TO DEFEND UNDER LIABILITY POLICY.—Nearly every liability insurance policy contains a clause in which the insurer agrees to defend suits brought against the insured. Such defense clauses are limited to suits for damages resulting from acts or omissions of the insured which are covered by the policy. The problem to be considered arises when the company refuses to defend, claiming that the action is not one which is covered by the policy. This situation frequently presents itself when the allegations in the complaint do not clearly establish whether the action is *within* the coverage or *outside* the coverage of the policy.

This problem has been the subject of much legal controversy

and has been called the "Insurance Company's Dilemma".[1] By electing to defend, the insurer waives its right to assert non coverage and will not be allowed to seek reimbursement from the insured for the costs of defense if in fact there was no coverage. By refusing to defend, the insurer gives up the valuable privilege of directing the defense of an action seeking damages which it may be required to pay. Since the courts have often based their decisions on the terms of the contracts and the particular wording therein many cases are applicable only to their own unique situations.

As a rule, the insurer is under a duty to defend any suit against the insured when the facts alleged in the complaint state a cause of action within the terms of the policy.[2] This is true even though the action is groundless or the allegations false.[3] Thus, the obligation to defend matures when the action is brought and does not depend upon the result of the trial.[4] It is immaterial whether the facts alleged are proved or not; the costs of defense will be taxed against the insurer.[5]

Besides the duty to defend, of course, the insurance company has the duty to pay; *i.e.*, the duty to compensate the judgment suitor. The relationship between these two duties is an important factor in the consideraton of the whole problem. Whether they are considered dependent or entirely independent will directly affect the the rights of the parties. It has been held that the duty to pay is of no consequence if the complaint brings the action within the risks covered by the policy.[6] In holding the insurer liable for defense costs, a New York court said,

> "The distinction between liabilty and coverage must be kept in mind. So far as concerns the obligation of the insurer to defend the question is not whether the injured party can maintain a cause of action against the insured but whether he can state facts

1. See comment, 2 Stan. L. Rev. 383 (1950) (Two possible solutions are offered, *viz.*, the nonwaiver agreement and the declaratory judgment. A nonwaiver agreement provides that the insurer will defend the suit against the insured, but that it reserves the right to later assert noncoverage. A declaratory judgment will definitely settle the question of the insurer's obligation to defend).

2. *See, e.g.*, Employers Mut. Liability Ins. Co. of Wis. v. Hendrix, 199 F.2d 53, 56-57 (4th Cir. 1952); Lee v. Aetna Cas. & Surety Co., 178 F. 2d 750, 752-753 (2d Cir. 1949); Christian v. Royal Ins. Co., 185 Minn. 180, 240 N.W. 365, 365-366 (1932).

3. *See, e.g.*, Employers' Liability A. Corp. v. Youghioheny & O. Coal Co., 214 F.2d 418, 422 (8th Cir. 1954); Bloom-Rosenblum-Kline Co. v. Union Indemnity Co., 121 Ohio St. 220, 167 N.E. 884, 886 (1929).

4. *See* Employers' Liability A. Corp. v. Youghiegheny & O. Coal Co., 214 F.2d 418, 422 (8th Cir. 1954).

5: Minnesota Electric Distributing Co. v. United States F. & G. Co., 173 Minn. 114, 216 N.W. 784 (1927).

6. Grand Union Co. v. General Acc., Etc., Assur. Corp., 254 App. Div. 274, 4 NY.S.2d 704, *aff'd*, 279 N.Y. 638, 18 N.E.2d 38 (1938).

> which bring the injury within the coverage. If he states such facts the policy requires the insurer to defend irrespective of the insured's ultimate liability." [7]

In one case the complaint alleged that the automobile causing the injury was hired by the insured and was being driven by an employee of the insured for whose actions he was responsible.[8] The court held the insurer under a duty to defend despite the fact that the insured had not hired the automobile in question and in reality had no connection whatsoever with the accident.

The majority of courts hold that a complaint filed against the insured, which on its face states circumstances not within the coverage of the policy, need not be defended by the insurer.[9] For example, a suit based on a complaint alleging the insured's automobile was driven by one under the age limit stated in the policy is not considered to be within the terms of the policy, and most courts will not hold the insurer liable for costs of defense.[10] This exact situation, however, came before an Ohio court in 1932 and the insurer was held obligated to defend.[11] The defense clause was construed as an unconditional promise to defend and independent of the other terms of the policy. This decision was later apparently overruled.[12] If an action is based on several grounds, only one of which is within its coverage, the insurer is required to defend.[13] The courts generally have ruled that the defense clause, while quite broad in its wording, is to some extent dependent on and correlative with the rest of the policy—in other words, the contract must be construed as a whole.[14] Any uncertainty or ambiguity in the contract is to be construed most strongly against the insurer and in

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7. *Id.* 4 N.Y.S.2d at 710.

8. Bloom-Rosenblum-Kline Co. v. Union Indemnity Co., 121 Ohio St. 220, 167 N.E. 884 (1929).

9. *See, e.g.*, Daniel v. State Farm Mut. Ins. Co., 233 Mo. App. 1081, 130 S.W.2d 244, 250 (1939); Farmers Cooperative Soc. No. 1 v. Maryland Gas Co., 135 SW.2d 1033, 1038 (Tex. Civ. App. 1939); U. S. Fidelity & Guarantee Co. v. Baldwin Motor Co., 34 S.W.2d 815, 819 (Tex. Comm. App. 1931).

10. *E.g.* United Waste Mfg. Co. v. Maryland Cas. Co., 85 Misc. 539, 148 N.Y.Supp. 852 (1914); Fulton Co. v. Massachusetts Bonding & Ins. Co., 138 Tenn. 278, 197 S.W. 866 (1917); Ocean Acci. & G. Corp. v. Washington Brick & Terra Cotta Co., 148 Va. 829, 139 S.E. 513 (1927).

11. Union Indemnity Co. v. Mostov, 41 Ohio App. 518, 181 N.E. 495 (1932).

12. Luchte v. State Automobile Mut. Ins. Co., 50 Ohio App. 5, 197 N.E. 421 (1935) (Injury resulted from insured's employee leaving a pile of coal in the street which plaintiff ran into on his motorcycle. Insurer was not required to defend under automobile liability policy).

13. Christian v. Royal Ins. Co., 185 Minn. 180, 240 N.W. 365 (1932).

14. *See e.g.*, American Fidelity Co. v. Deerfield Valley Grain Co., 43 F. Supp. 841, 845 (D. Vt. 1942); Continental Cas. Co. v. Pierce, 170 Miss. 67, 154 So. 279, 281 (1934). "It is a cardinal principle of construction that a contract is to be construed as a whole; that all its parts are to be harmonized so far as reasonably possible; that every word in it is to be given effect, if possible; and that no part is to be taken as eliminated or stricken by some other part unless such a result is fairly inescapable."

favor of the insured,[15] but the courts ". . . must avoid putting a strained and unnatural construction on the terms of the policy. . ." [16]

The application of the principle that the duty to defend is independent of the duty to pay has led to some rather unnatural conclusions. One frequently criticized case, for instance, held the insurer must pay the costs of defense where the plaintiff was injured while riding in insured's truck, even though the truck was excluded from coverage under the policy as a commercial vehicle.[17] In another case the costs of defense were imposed on the insurer though the complaint alleged the employee was under the eighteen year age limit of the policy.[18] It was held that the burden was on the insurer to prove the employee's non-age. It is an apparent inconsistency to require the insurer to determine by investigation the truth of the facts alleged on the face of the complaint when on the other hand, the courts allow the insured to rely on the complaint alone in demanding defense.

A situation of a more complex nature arises when the complaint neither brings the action clearly within the terms of the policy, nor establishes it as being outside the terms of the policy. A New York court said:

> "In such a situation it would seem to be the duty of the insurer to defend, if there is, potentially, a case under the negligence complaint, within the coverage of the policy. If, under the negli gence complaint a claim could be proved, which the insurer must pay, the duty to defend arises." [19]

In that case, the insurer had refused to defend on the ground that the complaint did not state a cause of action within the terms of the policy. The policy provided that the coverage ceased when the insured had completed its operations under a plumbing contract. The complaint merely alleged that the insured performed the work and the injury took place on the same day. In holding the insurer liable for the costs of defense, the court suggested that, in a situation such as this the insurer might protect itself by having the com-

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15. *See e.g.*, Lee v. Aetna Cas & Surety Co., 178 F.2d 750, 753 (2d Cir. 1949); Sampson v. Century Indemnity Co., 8 Cal. 2d 476, 66 P.2d 434, 436 (1937); Freese v. St. Paul Mercury Indemnity Co., 252 S.W.2d 653, 656 (Mo. 1952).

16. *See* Sampson v. Century Indemnity Co., 8 Cal. 2d 476, 66 P.2d 434, 437 (1937).

17. City Poultry & Egg Co. v. Hawkeye Cas. Co., 297 Mich. 509, 298 N.W. 114, 115 (1941). "We are of the opinion that the undertaking to defend and the undertaking for payment of damages are severable and independent. . . . The insurance company could have limited its obligation to the defense of suits where, on the facts, the insurance company was liable to the insured in case of judgment."

18. University Club v. American Mut. Liability Ins. Co., 124 Pa. Super. 480, 189 Atl. 534 (1937).

19. Pow-Well Plumbing & Heat. v. Merchants Mut. Cas. Co., 195 Misc. 251, 89 N.Y.S. 2d 469, 474 (1949).

plaint amplified by a bill of particulars. An earlier Texas case likewise held the insurer obligated to defend.[20] The court considered the facts alleged sufficient to apprise the insurer that the plaintiff was suing the insured as her employer, although the complaint stated the name of another. Thus, "The negligence complaint together with the policy (not the factual situation, determined by the insurer) establishes whether there is or is not a duty to defend." [21] On the other hand, if the insured settles the claim under consideration, ". . . questions of coverage, liability and the extent thereof are still open and are questions of fact." [22] The insurer is bound by the result of litigation on a claim within the policy if it has had notice and an opportunity to present its defense through its own counsel.[23]

Under the terms of most liability insurance policies, the insurer is under a duty to defend groundless suits.[24] The relation between the duty to defend and the other terms of the policy cannot be ignored even in the case of groundless suits. A clear statement of the correlation between these two duties was made by a Pennsylvania court:

> "It is obvious that the company's obligation was not to defend all suits and claims whatsoever merely because they were groundless, but to defend all suits and claims *covered by the policy whether or not* they were groundless." [25]

An insurer may be convinced that the complaint filed against its insured does not state a cause of action within the terms of the policy. The company may prefer to avoid the expense of a declaratory judgment and may merely decline to defend. If such were the case, would the insurer be exposing itself to liability in excess of the policy limits if the action proved to be within the coverage of the policy? In a leading Minnesota case the court held that the insurer was not liable for a judgment exceeding the limits of the policy.[26] The opinion stated that the failure to defend as required by the contract clearly did not create any greater liability. The insurer, however, had lost the exclusive right to direct the suit. The insurer, of course, was held liable for the entire cost of the

20. Travelers Ins. Co. v. Bluestein, 149 S.W.2d 252 (Tex. Civ. App. 1941).
21. Pow-Well Plumbing & Heat. v. Merchants Mut. Cas. Co., 195 Misc. 251, 89 N.Y.S.2d 469, 477 (1949).
22. *Id.* at 472.
23. *Id.* at 472.
24. 4 Richards, Insurance 2086 (5th ed., Freedman, 1952) (copy of standard policy).
25. Wilson v. Maryland Cas. Co., 377 Pa. 588, 105 A.2d 304, 306 (1954).
26. Mannheimer Bros. v. Kansas Cas. & Surety Co., 149 Minn. 482, 184 N.W. 189 (1921).

defense with no proportionate reduction based on his judgment liability.

A distinction between the refusal to defend and the refusal to settle must be kept in mind. An unreasonable refusal to accept a settlement will be considered bad faith and will subject the insurer to liabilty in excess of the express limits of the policy.[27] Some jurisdictions have held that an insurer's negligence in failing to settle will subject it to the same excess liability.[28] Mistake, however, will not be considered bad faith.[29] Whether a refusal to accept settlement is bad faith or not will depend primarily upon the circumstances of each case.[30]

EXHAUSTION OF POLICY LIMITS—DUTY TO DEFEND

An unusual situation presents itself when the amount specified as the limit of the company's liability has been exhausted. Obviously there is no duty to pay subsequent judgments and a logical assumption would be that the duty to defend is also terminated.

This was not the result reached, however, by the New York Supreme Court in *American Employers Ins. Co. v. Goble Aircraft Sp.*[31] The insurer had agreed to pay negligence judgments obtained up to a limit of $300,000.00 per accident. One of the insured's pleasure vessels floundered due to insured's failure to secure accurate weather reports and forty-six persons lost their lives. Eleven separate wrongful death actions were instituted claiming an aggregate recovery of $1,476,830.60. Insurer petitioned for declaratory judgment to determine, *inter alia,* whether it was required to defend the actions beyond the policy limits. It was held that the insurer must defend all actions based upon the disaster covered in the policy. It is significant to note that the policy contained the usual defense clause.

The first theory advanced by the court in holding the insurer liable for defense costs was based on the wording of the defense clause.

"As we read the policy, the obligation to defend applies to accidents within the scope of the hazards covered during the calendar life of the contract. Nowhere is there language making

27. *E.g.,* American Fidelity & Cas. Co. v. G. A. Nichols Co., 173 F.2d 830 (10th Cir. 1949); American Mut. Liability Ins. Co. v. Cooper, 61 F.2d 446 (5th Cir. 1932); Brassil v. Maryland Cas. Co., 210 N.Y. 235, 104 N.E. 622 (1914).

28. Douglas v. U.S. Fidelity & Guaranty Co., 81 N.H. 371, 127 Atl. 708 (1924); Tyger River Pine Co. v. Maryland Cas. Co., 170 S.C. 286, 170 S.E. 346 (1933); 8 Appleman, Insurance Law and Practice § 4713 (1942).

29. Mendota Electric Co. v. Indemnity Co., 175 Minn. 181, 221 N.W. 61 (1928).

30. *See* National Mut. Cas. Co. v. Britt, 203 Okla. 175 200 P.2d 407, 412 (1948),

31. 205 Misc. 1066, 131 N.Y.S.2d 393 (1954).

> the defense provisions dependent upon the exhaustion of the specified coverage. The phraselogy used by plantiff 'as respects the insurance afforded by the other terms of this policy the company shall: (a) defend any suit against the insured***' is clear positive and unambiguous and should be accorded its plain and ordinary meaning." [32]

In direct conflict with this interpretation is a case involving similar facts and an identical defense clause. The court said:

> "It [the insurer] was obligated to defend [the insured] *'as respects insurance afforded* by this policy', and *there being no further insurance afforded,* we are of the view that its obligation to defend was likewise terminated. Defendant's theory would produce the incongruous situation that plaintiff would have a continuing obligation to defend, notwithstanding its obligation to pay has been exhausted. We are of the view that no such liability was intended by the provisions in question and that it cannot reasonably be so construed." (italics supplied) [33]

The two cases cannot be distinguished. In each, the aggregate total of damages sought in suits pending far exceeded the limits of the company's liability; and in each, the company had been willing to defend actions as long as insurance remained. The very wording of the policies limits the benefit of free defense to the policy "terms". Certainly one of the terms of the policy is the limit upon liability.

A second theory advanced in the *Goble* case was based upon the premise that the promise to defend is an undertaking for the benefit of the insured, not the insurer.[34] However, it seems that the insured has received his benefit when the insurer defends action within the terms of the policy, *i.e.,* within the limits of liability. The promise to defend is also clearly an undertaking for the benefit of the insurer since it reserves to the insurer the *exclusive* right to direct the defense.[35] Thus, the promise is actually for the benefit of both parties.

The third theory offered in the *Goble* case was, "' . . . that the undertaking to defend and the undertaking for payment of dam-

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32. American Employers Ins. Co. v. Goble Aircraft Sp., 205 Misc. 1066, 131 N.Y.S.2d 393, 400 (1954).

33. Danham v. La Salle-Madison Hotel Co., 168 F.2d 576, 584 (7th Cir.), *rehearing denied,* 335 U.S. 871 (1948).

34. *Cf.* Lumbermen's Mut. Cas. Co. v. McCarthy, 90 N.H. 320, 8 A.2d 750, 753 (1939) (dissenting opinion). ". . . the answer given in the majority opinion disregards the language in the policy and construes the promise of the insurance company to defend, not as an undertaking for the benefit of the assured, but as a stipulation for the benefit of the insurer."

35. Johnson v. Hardware Mut. Cas. Co., 108 Vt. 269, 187 Atl. 788 (1936); 4 Richards, Insurance, 2086 (5th ed., Freedman, 1952) (copy of standard policy).

ages were severable and independent.'"[36] This principle was adopted by the Supreme Court of Michigan in attaining a result inconsistent with the majority of cases dealing with the insurer's duty to defend actions outside the terms of the policy.[37] The question of how far the principle was intended to apply presents itself. Its application in most cases will volate a cardinal rule of contract construction, *viz.*, the contract must be construed as a whole.[38] It ignores the intention of the parties to take one clause out of context and apply it with no regard to the instrument of which it is a part. To be sure that the clause would not be interpreted independently, the policy expressly states that defense will be provided, ". . . as respects the insurance afforded by the other terms of this policy. . ."[39] These words necessarily limit the application of the clause to the rest of the policy.

The court in the *Goble* case cited one case holding the insurer liable for defense costs of suits after exhaustion of the limit of liability.[40] However, an examination of that case reveals that there, the policy limit had been exhausted only as to liability for bodily injury. The subsequent suit which the insurer sought to avoid defending claimed damages under the South Carolina survival statute for pain and suffering *and property damage* without separation of amount. Since the insurer still had an obligation to pay for property damage, it was held under a duty to defend the suit. This reasoning is clearly not applicable to the *Goble* case where the entire limits of all liability had been exhausted.

The effect of the holding in the *Goble* case was to require the insurance company to defend, at its own cost, actions claiming nearly one and one half million dollars damages, as a result of issuing a policy of insurance with express limits of $100,000 and $300,000. It seems highly improbable that the parties to the contract intended this result.

Conclusion

Most of the nation's largest liability insurance companies have now adopted a standard policy form.[41] The insurer's duty to de-

36. American Employers Ins. Co. v. Goble Aircraft Sp., 205 Misc. 1066, 131 N.Y.S.2d 393, 400 (1964).

37. City Poultry & Egg Co. v. Hawkeye Cas. Co., 297 Mich. 509, 398 N.W. 114 (1941); See Appleman, Insurance Law and Practice §4684 n. 43 (1942).

38. *See, e.g.*, American Fidelity Co. v. Deerfield Valley Grain Co., 43 F. Supp. 841, 845 (D. Vt. 1942); Continental Cas. Co. v. Pierce, 170 Miss. 67, 154 So. 279, 281 (1934).

39. 4 Richards, Insurance 2086 (5th ed., Freedman, 1952) (standard policy).

40. American Cas. Co. of Reading v. Howard, 187 F.2d 322 (4th Cir. 1951).

41. 4 Richards, Insurance 2083-2092 (5th ed., Freedman, 1952) (for an example of a standard liability policy).

fend is set out in the following words in the National Standard Policy:

> "As respects the insurance afforded by the other terms of this policy the Company shall:
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> (a) defend in his name and behalf any suit against the Insured alleging such injury or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but the Company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the Company;"[42]

Perhaps this clause is not so clear and unambguous as to eliminate all controversy. Uniform interpretation of the policy by a number of courts over a period of years would, however, lead to a body of case law which the parties could look to for determination of their respective rights under the insurance agreement.

Nearly all of those cases reaching anomalous results base their conclusions upon essentially the same doctrine: the duty to defend is independent of the duty to pay. It has been pointed out previously that the doctrine is inconsistent with well established rules of contract construction. It singles out one promise of the insurer and regards that promise alone as unconditional and bearing no relation to the parent instrument. Yet, the doctrine is not entirely wrong; it merely goes too far. It would lead to less confusion and greater uniformity of application if a new principle were substituted in its place: *the duty to defend is broader than the duty to pay.*[43] Thus, the distinction between the two would be recognized without losing sight of their relation.

JON N. VOGEL

TORTS—CHARITABLE INSTITUTIONS—IMMUNITY FROM TORT LIABILITY.—What is that abstraction called "justice"? As relating to jurisprudence, it has been defined as the constant and perpetual disposition to render every man his due.[1] However, the process of rendering every man his due is conditioned upon the mores of a particular society at a particular time. The development of social concepts must, of necessity, imply a parallel development in the law of the land if the ends of justice are to be attained.

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42. 4 Richards, *op. cit. supra* note 41 at 2086.

43. *See* Golberg v. Lumber Mut. Cas. Ins. Co., 297 N.Y. 148, 77 N.E.2d 131, 133 (1948).

1. *See* Borden v. State, 11 Ark. 519, 54 Am.Dec. 217, 221 (1851).