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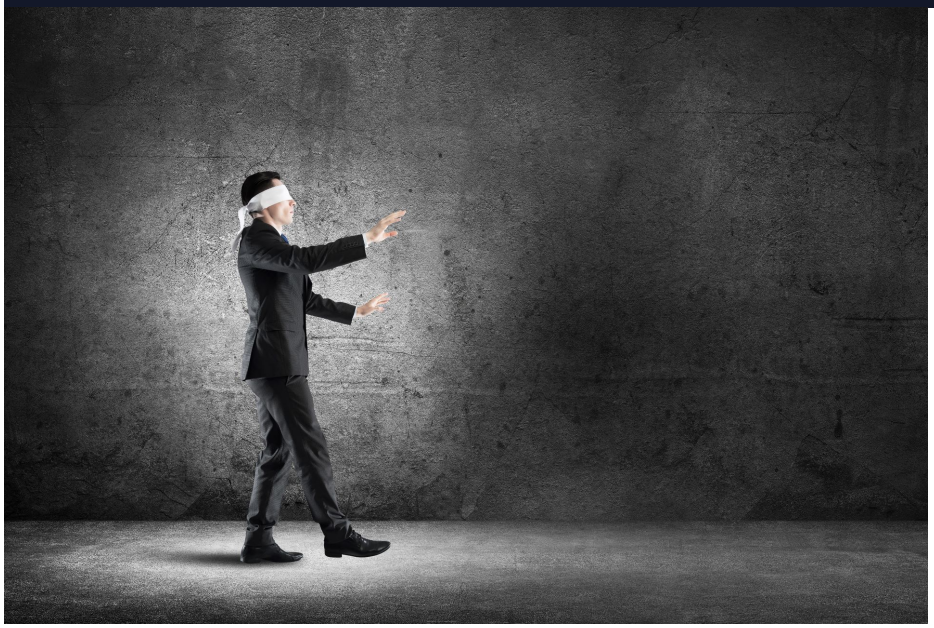

Out Of Sight, But Not Out Of Mind: Facts Outside The Pleadings And The Duty To Defend

October 15, 2021 | Policyholder Protection,Duty To Defend

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Does an insurance company have a duty to defend a lawsuit against your company where the actual facts of the claim are within coverage, but the complaint fails to mention potentially covered facts?

Perhaps surprisingly, the answer depends on the state law that governs the questions of insurance policy interpretation. Consider the following example in which the complaint is silent as to potentially covered allegations, but the true facts should be covered under the policy.

Let's start with a company that we'll refer to for now as 654 Enterprises, a general contractor on a construction project. A worker employed by a subcontractor is severely injured while climbing down a ladder and brings a personal injury lawsuit against 654 (but not against his own employer). The worker alleges 654 failed to keep the construction site clean after a series of rainstorms led to the accumulation of mud that compromised the ladder's stability. During the course of litigation, however, it is revealed that the principal cause of the worker's injuries was his own negligence: His feet got tangled in an extension cord he was carrying, causing him to trip and fall.

That development is important. 654 is an additional insured on the subcontractor's Commercial General Liability (CGL) policy, but the insurance carrier says its policy only covers 654 where injuries arise out of the acts or omissions of the named insured subcontractor or those acting on its behalf. Although it is undisputed that the worker's fall was the result of tripping over

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his own cord, his lawsuit makes no mention of this. The subcontractor's insurance company denies 654 coverage, taking the position that its duty to defend has not been triggered because there is no allegation in the complaint of negligence by the subcontractor or those working on its behalf (i.e., the worker or others doing work for the subcontractor).

Whether the insurance company's position is correct largely depends on what law governs the construction of the insurance policy. General liability insurance policies rarely have a choice of law clause.

A minority of jurisdictions, most notably Texas, adheres to what is known as the "eight-corners" rule, under which the duty to defend – that is, the insurer's contractual obligation to defend the insured against lawsuits and claims – is determined by strictly comparing the allegations in the complaint (the first "four corners") with the terms of the insurance policy (the remaining "four corners"). Under this rule, facts extrinsic to the allegations in the complaint – no matter how salient to the case – are effectively nonexistent for purposes of determining whether the insurance company has a duty to defend. The results can be particularly harsh where, as in the above scenario, the complaint as drafted fails to allege the undisputed facts that, had they been alleged, would have triggered the insurer's duty to defend. In the above case – *Gilbane Building Co. v. Admiral Insurance Co.*, 664 F.3d 589 (5th Cir. 2011) – the Fifth Circuit Court of Appeals held in favor of the insurance company's denial of coverage on the basis of Texas' strict version of the eight-corners rule.

The eight-corners rule has not been widely adopted because while it is conceptually clear, it renders the policyholder's rights to coverage subject to the whims of the lawyers drafting the complaint and ignores the actual facts of the case. Accordingly, in most jurisdictions, an insurer also has a duty to defend "where extrinsic facts known to the insurer suggest that the claim may be covered." *Hartford Cas. Ins. Co. v. Swift Distribution, Inc*. (2014) 59 Cal.4th 277, 287; see also *Durant v. North Country Adirondack Coop. Ins. Co.*, 24 A.D.3d 1165, 1166 (N.Y. App. Div. 2005) ("extrinsic evidence may be used to expand the insurer's duty to defend"). Under the majority rule, the insurance company's knowledge of the worker's negligence – though not alleged in the complaint – likely would trigger its duty to defend, all else being equal.

While extrinsic evidence may trigger the duty to defend in most jurisdictions, generally the reverse – that extrinsic evidence can defeat that duty – is not the case. This is because the purpose of the duty is to protect the policyholder from potentially covered claims without regard to the factual or legal merit of those claims. Permitting insurers to deny coverage on the basis of extrinsic facts effectively undermines the general principle that an insurance company has a duty to defend against potentially covered allegations, even if false, frivolous or fraudulent. Nevertheless, some courts permit extrinsic evidence to terminate an insurance company's duty to defend in limited circumstances, such as where the litigants have colluded to arrange for a pleading that omits facts that would defeat coverage (*Loya Insurance Co. v. Avalos*, 610 S.W.3d 878 (Tex. 2020)), or when the extrinsic facts in question are unrelated to the merits of the allegations in the pleading (*GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 310 (Tex. 2006)).

In summary, courts in most jurisdictions generally utilize undisputed evidence outside the pleadings to trigger, rather than to eliminate, an insurance

company’s duty to defend. In the event your business faces a lawsuit that omits the facts most favorable to coverage, consider whether experienced coverage counsel can evaluate whether there still is the potential for coverage, so that your business receives the full benefit of the insurance company’s promise to defend its insureds.

This article was originally published in the 2021 edition of Corporate Policyholder Magazine.