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Under California Law, an Insurer's Duty to Defend is Based on Facts Alleged in the Complaint and Facts Otherwise Known by the Insurer; Speculation and Arguments are not Relevant to the Duty to Defend Analysis

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A common dispute between carriers and insureds involves the scope of information that may be considered when determining whether a duty to defend exists. Under California law, an insurer's duty to defend is determined by facts – both facts alleged in the underlying complaint and facts known or available to the insurer from any source. It is no surprise that the insured and its counsel may supply facts outside of the complaint when seeking coverage. This leaves the insurer to determine whether the information it receives, be it facts, argument or speculation, should bear on the duty to defend analysis. As explained below, California case law demonstrates that the duty to defend cannot be based on unfounded attempts to manufacture coverage by "connecting the dots" between allegations and coverage. Rather, the duty to defend should be determined based only on supported facts.

The Duty to Defend May Be Triggered by Facts Outside of the Tendered Complaint

In the most basic analysis, an insurer's duty to defend is triggered when the facts alleged in the complaint create a potential for coverage. *See Scottsdale Ins. Co. v. MV Transp.*, 36 Cal. 4th 643, 654 (2005). Although an insurer must consider extrinsic facts in evaluating the duty to defend, this does not open the floodgates for coverage – an insurer does not need to accept speculation regarding the allegations in the underlying action as facts. As the court in *Gunderson v. Fire Insurance Exchange*, 37 Cal. App. 4th 1106, 1116 (1995) explained, "[a]n insured may not trigger the duty to defend by speculating about extraneous 'facts' regarding potential liability or ways in which the third party claimant might amend its complaint at some future date." Likewise, in the case of *Hurley Construction Co. v. State Farm Fire and Casualty Co.*, 10 Cal. App. 4th 533, 538 (1992), the court found that speculation from an insured's counsel regarding how a claimant might amend its complaint could not trigger coverage. *See also Friedman Prof. Mgmt. Co., Inc. v. Norcal Mut. Ins. Co.*, 120 Cal. App. 4th 17, 34–35 (2004) ("[T]he universe of facts bearing on whether a claim is potentially covered . . . does not include *made up facts*, just because those facts might naturally be supposed to exist along with the known facts.") (emphasis original).

Against this backdrop – where the duty to defend may be triggered by facts not stated in the complaint, but where speculation regarding "facts" is not enough – the insurer must weigh what information may bear on coverage. This can be an important question, as "[a]n insurance company can [] get into trouble by refusing to consider facts it knows, but which are extrinsic to the complaint and which show . . . a potential for coverage." *Griffin Dewatering Corp. v. Northern Ins. Co. of New York*, 176 Cal. App. 4th 172, 197-199 (2009).

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The Perils of Disputing Facts that Trigger Coverage

Amato v. Mercury Casualty Co., 18 Cal. App. 4th 1784 (1993) demonstrates the challenges that come into play when considering extrinsic facts. In *Amato*, the insured was involved in a car accident while driving with his mother-in-law, and the mother-in-law sued the insured. The policy precluded coverage for claims by people who resided with the insured. The insured, however, claimed that he did not live with his mother-in-law. As part of the insurer's investigation, the insurer called the mother-in-law's house and was informed the insured did not live at the residence. The insurer did not believe the insured and denied coverage.

In finding that the insurer was incorrect in its denial, the court noted that the insurance company "possessed information which, if true, indicated that [he] was residing at locations other than the home of" his mother-in-law at the time of the accident. *Id.* at 1789. In addition to the phone call in which the insurer was advised the insured did not live at the mother-in-law's residence, the *Amato* court also noted that, within a week of the accident, the insured had filed a change of address notice with the DMV, indicating the insured had moved from the mother-in-law's home, and found that this information was available to the insurer at the time of the declination of coverage.

Even though at trial, the jury had found that the insured lived with his mother-in-law at the time of the accident – i.e., that the insurer's assessment of the true facts was correct – the *Amato* court nonetheless found the insurer liable for failing to acknowledge the duty to defend because, at the time of the coverage decision, the insurer had facts available to it that created a potential that the exclusion did not apply. While one might question if *Amato* was correctly decided, the lesson for insurers that can be taken from *Amato* is that the duty to defend will be determined by the "facts" – and they must be "facts" – available to the insurer at the time.

The Importance of Supported Facts over Speculation of the Insured or Counsel

But what if the insurer in *Amato* did not have facts available showing that the insured did not live with his mother-in-law, but instead had only statements from the insured's counsel that the insured had moved? Could this alone trigger the duty to defend? California courts addressing this situation say "no" – an attempt by counsel or the insured to "connect the dots" between facts at issue in the underlying case and coverage cannot, by itself, trigger the duty to defend. As discussed below, however, it can sometimes be a challenge to discern between uncorroborated argument and supported facts.

In *Staff Pro, Inc. v. National Union Fire Insurance Co.*, 2006 Cal. App. Unpub. LEXIS 5919, at *7 (July 5, 2006), the insurer denied coverage on the grounds that the underlying complaint did not allege any sort of covered advertising injury. In response to the denial, counsel for the insureds argued that the claimant planned to use arguments regarding the insureds' website advertising to prove its case against the insureds, so that the action involved covered advertising injury. The insurer asked for additional information supporting this argument, including deposition testimony. Counsel for the insureds failed to provide the testimony for months and, when he did, the insurer determined that the neither the insureds' website nor the deposition testimony supported the argument that the claimant intended to assert any theories based on the insureds' advertising. *Id.* at *9-11.

In its analysis, the *Staff Pro* court agreed that the underlying complaint, the insureds' website and the deposition testimony did not reveal a potential for coverage. The court then explained that, according to the insureds, their

counsel's representations "'connected the dots' between [the claimant's] predatory pricing claim and [the insured company's] advertising." *Id.* at *21. Relying on *Gunderson* and *Hurley*, the court rejected the argument that counsel's statements regarding the allegations in the underlying action were "facts" that could trigger the duty to defend. Rather, "[counsel's] 'explanation' was merely his characterization or analysis of [the claimant's] arguments and theories and his speculation as to how [the claimant] might try to prove its claims at trial. But there was no *evidence or facts* to support [counsel's] explanation." *Id.* at *23-24 (emphasis original). Addressing *Amato*, the court explained that "[h]ere, [the insureds] did not provide [the insurer] with 'facts' which, if true, would establish a potential for coverage; rather, they provided respondent with their counsel's uncorroborated analysis of the third party's claims. An insured's counsel's 'self-serving legal opinion' about potentially covered claims 'hardly constitutes a 'fact' known to [the insurer] which, under *Gray*, gives rise to a . . . duty to defend.'" *Id.* at*25-26 (quoting *Nat'l Union Fire Ins. Co. v. Siliconix Inc.,* 726 F. Supp. 264, 272 (N.D. Cal. 1989)).

Tower Insurance Co. v. Capurro Enterprises, Inc., 2011 U.S. Dist. LEXIS 144436, at *16-18 (N.D. Cal. Dec. 15, 2011) arguably came to a contrary conclusion in dicta. In *Tower*, the insured was sued by a former franchisor for, among other things, improperly using the franchisor's protected trademarks. *Id.* at *4-5. In tendering the action to the insurer, counsel for the insured explained that the insured was accused of using the franchisor's advertising ideas, copyright, trade dress and slogans in advertising, so that the CGL policy at issue provided coverage. *Id.* at *8. Counsel also explained that it was possible that certain advertisements may have continued to be broadcasted by the insured using allegedly infringing material. *Id.* The insurer denied coverage, arguing that the complaint alleged no facts suggesting that the insured infringed any trade dress or slogans in any advertisement. *Id.* at *9. In response, counsel for the insured explained that the insured was unable to remove "wrapping" from its company van, which included protected slogans and advertising, so the insured arguably continued to advertise using infringing material. *Id.* at *17. The insurer maintained its denial and, apparently, did not ask for images of the van until discovery in the coverage action. *Id.* at *18.

In analyzing the duty to defend, the court first found that, contrary to the insurer's analysis, the underlying complaint included allegations that may trigger coverage, although it was a close issue. *Id.* at *16. Since it found the allegations in the complaint itself triggered a duty to defend, the *Tower* court did not need to address whether the statements of counsel regarding the "wrapping" on the insured's company van potentially gave rise to coverage. Nevertheless, the *Tower* court went on to suggest that the statements of the insured's counsel could potentially give rise to coverage. *Id.* at *17-18. In making these comments, the court expressly noted that the insurer failed to seek corroborating evidence regarding the "wrapping" until discovery in the coverage action and found that, at the outset of the underlying action, the insurer was on notice of facts that could trigger coverage. *Id.* at *18. Thus, it appears that the *Tower* court's concern was that the insurer did not attempt to corroborate counsel's statement regarding the "wrapping" of the vehicle at the time it was making its coverage determination.

Connecting the Dots vs. Corroborated Facts

There is a line between facts extrinsic to a tendered complaint that may trigger coverage and mere speculation from an insured or its counsel. That line may not always be clear, but, as demonstrated in *Staff Pro*, California courts have found that statements or conjecture from counsel or the insured, uncorroborated by evidence, will not trigger the duty to defend. Rather, the insurer has the right to demand evidence supporting the statements from the insured or its counsel and, in the absence of evidence corroborating such arguments, efforts by the insured or

its counsel to “connect the dots” are just speculation which cannot create a duty to defend.

An insurer, of course, cannot dismiss or ignore information that might impact the coverage evaluation. As demonstrated by *Tower* and *Amato*, the insurer must consider “facts” provided by the insured or its counsel and request corroborating evidence. If supporting evidence is not forthcoming or does not actually support the arguments advanced by the insured or its counsel, as in *Staff Pro*, the insurer may properly decline coverage. If, however, the insurer is provided evidence suggesting the arguments of counsel or the insured are actually rooted in fact, then a duty to defend may be triggered.

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