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Note

The Insurer's Duty to Defend: New York Folds the Four Corners of the Complaint Rule in *Fitzpatrick v. American Honda Motor Co.*

I. Introduction

The insurer's duty to defend its insured has been the subject of legal controversy for many years.¹ This controversy is destined to continue as the expense of defending claims continues to rise.² In a standard liability policy, also known as a "dual promise" policy,³ an insurer is obligated to defend its insured

1. The insurer's duty to defend issue has resulted in considerable commentary: See, e.g., Andrew Janquitto, *Insurer's Duty To Defend in Maryland*, 18 U. BALT. L. REV. 1 (1988); David S. Garbett, *The Duty To Defend Clause in a Liability Insurance Policy; Should the Exclusive Pleading Test Be Replaced?*, 36 U. MIAMI L. REV. 235 (1982). This issue has also arisen within extensive case law in New York State. See, e.g., *Lee v. Aetna Cas. & Sur. Co.*, 178 F.2d 750, 751 (2d Cir. 1949) (applying New York law, Judge Learned Hand stated "it is the claim which determines the insurer's duty to defend"); *A. Meyers & Sons Corp. v. Zurich Am. Ins. Group*, 74 N.Y.2d 298, 545 N.E.2d 1206, 546 N.Y.S.2d 818 (1989); *Ruder & Finn Inc. v. Seaboard Sur. Co.*, 52 N.Y.2d 663, 422 N.E.2d 518, 439 N.Y.S.2d 858 (1981); *International Paper Co. v. Continental Cas. Co.*, 35 N.Y.2d 322, 320 N.E.2d 619, 361 N.Y.S.2d 873 (1974); *Goldberg v. Lumber Mut. Cas. Ins. Co.*, 297 N.Y. 148, 77 N.E.2d 131 (1948).

2. See INSURANCE SERVICES OFFICE, INC., *LEGAL DEFENSE: A LARGE AND GROWING INSURANCE COST* (1989). Insurer's legal defense costs rose an average of 16% per year during the period 1978-1988. *Id.* at 4. Insurers incurred legal defense costs of 11.8 billion dollars in 1988, up from 2.8 billion in 1978, an increase of 320%. *Id.*

3. The "dual-promise" policy consists of two promises: the promise to defend and the promise to indemnify. See Raoul D. Kennedy, *The Duty To Defend*, in *INSURER VS. INSURER DISPUTES* 1990, at 25, 27 (PLI Commercial Law and Practice Course Handbook Series No. 534, 1990).

against third-party claims alleging liability within the policy's coverage.⁴ Therefore, the standard liability policy provides both indemnity and "litigation" insurance.⁵

Insurance is an integral component of society that leaves virtually no person untouched. Justice Black wrote in *United States v. South-Eastern Underwriters Association*:⁶ "Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States."⁷ In 1990, property/casualty insurers wrote⁸ over 217 billion dollars in premiums nationwide.⁹ Of these premiums, 18 billion dollars worth were written by 205 property/casualty insurers with home offices in New York State.¹⁰ The insurance industry has been labeled as one of the most important in this country and may be the single largest purchaser of legal services.¹¹

4. *Ruder & Finn*, 52 N.Y.2d at 670, 422 N.E.2d at 521, 439 N.Y.S.2d at 861.

5. *International Paper*, 35 N.Y.2d at 326, 320 N.E.2d at 621, 361 N.Y.S.2d at 876.

6. 322 U.S. 533 (1944). In *South-Eastern Underwriters Association*, one of the most important cases in insurance history, it was held that insurance transactions were subject to federal regulation under the Commerce Clause, thereby removing the constitutional impediment to federal regulation of the insurance industry. *Id.*

7. *Id.* at 540.

8. Insurance is written by "underwriters" who technically can be the insurance company or a company employee. FREDERICK G. CRANE, *INSURANCE PRINCIPLES & PRACTICES* 401 (1980). Underwriting is the process of determining what risks to accept and how to insure them. *Id.* The word "underwriting" has an interesting origin in that it evolved from a seventeenth century practice:

The word "underwriter" originated at Lloyd's. In the late 1600s, a man named Edward Lloyd ran a coffeehouse in London. Lloyd's coffeehouse came to be known as a place where shipowners could go to find men interested in insuring ships and cargoes. The shipowners would go from table to table at the coffeehouse and various men would agree to insure part of the shipowners' risks. They did so by writing their names underneath a description of the risks being insured. (Thus, they were "underwriting" the risks). Sometimes an underwriter would add the names of friends who didn't have time to go the coffeehouse themselves but who wanted to invest some of their funds in the hope of earning a profit. These "names" would have given the underwriter permission to accept risks on their behalf. The business is conducted in essentially the same way today [as Lloyd's of London].

Id. at 428.

9. Telephone Interview with Nancy Williamson, Insurance Information Institute (Feb. 10, 1992).

10. *Id.*

11. ROBERT F. CUSHMAN ET AL., *PROSECUTING AND DEFENDING INSURANCE CLAIMS* v (1989).

Along with the insurance industry's growth there has been an explosion in civil lawsuits filed¹² and an increase in costs of defense.¹³ The Insurance Services Office¹⁴ has estimated that in 1988, insurers spent about 33 cents on legal defense costs for every dollar spent on indemnity.¹⁵ Accordingly, the duty to defend aspect of the standard liability insurance policy has become a matter of substantial concern for both insurers and insureds.¹⁶

This Note will examine the insurer's duty to defend in New York in light of a recent decision by the New York Court of Appeals. In *Fitzpatrick v. American Honda Motor Co.*,¹⁷ the court, in a 5-4 decision, abandoned the well established "four corners of the complaint" rule¹⁸ used to determine when an insurer has a duty to defend.¹⁹ The court held that a rigid application of the four corners of the complaint rule "exalts form over substance,"²⁰ and then pronounced the new rule: "[An insurer must] provide a defense where, notwithstanding the complaint allegations, underlying facts made known to the insurer create a 'reasonable possibility that the insured may be held liable for some act or omission covered by the policy.'"²¹

Part II of this Note explores the source, nature, and scope of the duty to defend as it existed pre-*Fitzpatrick*. Also included

12. See INSURANCE INFORMATION INSTITUTE, 1987-88 PROPERTY/CASUALTY FACT BOOK 8 (1988). The number of civil cases filed in federal courts has skyrocketed over the last decade and a half from 87,300 in 1970 to 254,800 in 1986. *Id.*

13. See INSURANCE SERVICES OFFICE, *supra* note 2, at 4.

14. The Insurance Services Office is an insurance industry supported statistical and advisory rating organization that prepares advisory policies for the insurance industry. James K. Killelea, *Format of Liability Insurance Policies*, in INTRODUCTION TO BUSINESS INSURANCE, at 229, 277 (PLI Litig. & Admin. Practice Course Handbook Series No. 296, 1985).

15. See INSURANCE SERVICES OFFICE, *supra* note 2, at 7. This figure applies to general liability defense costs. *Id.*

16. ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 9.1(a), at 987 (1988).

17. 78 N.Y.2d 61, 575 N.E.2d 90, 571 N.Y.S.2d 672 (1991).

18. Although this rule is known by several different names, this name will be used because it is the name used for the rule in *Fitzpatrick*. The descriptive name for the rule means that an insurer may only use the facts as alleged within the four corners of the complaint to determine whether it has a duty to defend. See *infra* notes 49-50 and accompanying text.

19. *Fitzpatrick*, 78 N.Y.2d at 70, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

20. *Id.*

21. *Id.* (quoting *A. Meyers & Sons Corp. v. Zurich Am. Ins. Group*, 74 N.Y.2d 298, 302, 545 N.E.2d 1206, 1208, 546 N.Y.S.2d 818, 820 (1989)).

in this section is a discussion of the standard procedure used when an insured requests his contracted-for defense, the role of the four corners of the complaint rule as it previously existed, and the unique situation of the non-duty to defend policy. The *Fitzpatrick* procedural history and facts along with the underlying reasoning of the majority and dissenting opinions are set forth in Part III. Part IV examines the implications of *Fitzpatrick* and recommends an extrinsic fact documentation requirement that courts should adopt in applying the new rule.

II. Background

A. *The Insurer's Duty To Defend*

1. *The Source of the Duty To Defend*

No duty to defend exists on the part of an insurer at common law; the duty instead flows from the insurance policy as a contractual obligation undertaken by the insurer.²² A standard insurance policy contains two distinct, primary duties: (1) the duty to indemnify the insured, and (2) the duty to defend the insured.²³ Therefore, it is well established that a standard liabil-

22. See ROBERT H. JERRY, UNDERSTANDING INSURANCE LAW 561 (1987). The language of the insurance policy gives rise to the contractual obligation of the insurer to defend the insured. *Id.* Once the policy is agreed upon and signed, the contract is formed and reciprocal rights and duties come into existence. *Id.* at 563. However, as with most contractual duties, the insurer's duty to defend is not unlimited and is only triggered by claims that fall within coverage afforded by the policy. *Id.*

23. See *id.* at 561. For purposes of this discussion, the standard liability insurance policy referred to will be a Comprehensive General Liability (CGL) policy. The CGL policy also accurately reflects the duty to defend provision as it existed in the insurance policy in *Fitzpatrick*. The CGL policy is a standard policy form written by the Insurance Services Office, Inc. (ISO). The typical CGL policy provides:

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

Coverage A. bodily injury or

Coverage 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 JOHN A. APPLEMAN, INSURANCE LAW AND PRACTICE § 4682, at 22 n.9 (1979).

ity insurance policy provides not only indemnity insurance to pay "all sums for which the insured shall become legally obligated to pay as damages,"²⁴ but also "litigation insurance"²⁵ to pay for all legal defense costs.

Because the standard liability policy is a contract, certain legal requirements must be met.²⁶ Once the parties form the contract, certain rights and obligations come into existence.²⁷ The classic contract formation model envisions parties with equal bargaining power and an informed negotiation process throughout the offer and acceptance stage.²⁸ Insurance contract formation, however, is in many ways far removed from this classic model. Most insurance policies are standard form contracts²⁹ judicially classified as adhesion contracts.³⁰ These contracts have historically been reviewed with a heightened judicial scrutiny to protect the consumer.³¹

24. APPLEMAN, *supra* note 23, § 4682, at 22 n.9.

25. *International Paper Co. v. Continental Cas. Co.*, 35 N.Y.2d 322, 326, 320 N.E.2d 619, 621, 361 N.Y.S.2d 873, 876 (1974).

26. To create a valid contract enforceable at law, the parties must (1) make a manifestation of mutual assent through offer and acceptance, (2) provide consideration to support the promises, (3) possess capacity to contract, (4) satisfy the applicable writing requirement, and (5) contract for a purpose that is not contrary to public policy. JERRY, *supra* note 22, at 131.

27. For example, the insurer is obligated to defend and indemnify the insured for liability arising out of any covered event under the policy and the insured is required to pay premiums, give the insurer notice of covered events and cooperate with the insurer in relation to defense of actions. *See generally* ALLAN D. WINDT, *INSURANCE CLAIMS AND DISPUTES* §§ 3.01-3.12 (2d ed. 1988).

28. JERRY, *supra* note 22, at 138.

29. Standard form contracts have several advantages: (1) they allow the consumer to price shop by comparing different insurance company premium rates for the same contract type; (2) they are an industry time saver by making individual negotiation unnecessary; (3) they allow the industry to evaluate the risks insured more predictably; and (4) they allow for judicial interpretation of one contract to serve as a guide for the interpretation of all the contracts written in that standard form, which directly promotes judicial economy. *Id.* at 145.

30. A contract of adhesion exists where the insured did not have any opportunity to participate in the drafting of the contract, as with standard form contracts, and thus the insured does not have any choice but to adhere to the contract. *See* ROBERT RIEGEL, *INSURANCE PRINCIPLES AND PRACTICES* 37 (6th ed. 1976). As a result of insurance contracts being deemed adhesion contracts, the courts often invoke the doctrines of waiver, estoppel, reformation, and rescission to protect the insured, which in effect create rights for the insured where none existed in the language of the policy. JERRY, *supra* note 22, at 105.

31. JERRY, *supra* note 22, at 146.

Standard liability form contracts are widely used, and each policy type is tailored to meet the needs of insuring a specific risk or set of risks. The Comprehensive General Liability Policy (CGL) is designed to cover the insured against a broad range of liabilities³² and consequently it covers damages sustained by any claimant caused by an insured occurrence.³³ Under the CGL Policy, the duty to defend is expansive because it is broadened in proportion to the duty to indemnify.³⁴ In contrast to the CGL, two examples of narrowly tailored liability policies are the Owners' and Contractors' Protective Insurance Policy³⁵ and the Manufacturers' and Contractors' Liability Policy.³⁶

The Owners' and Contractors' Protective Insurance Policy is designed to cover the insured's liability arising out of operations performed for the insured by independent contractors, and for liability arising from negligent supervision of the contractor by the insured in connection with such operations.³⁷ A primary reason for purchasing this type of policy is the duty to defend provision, that benefits the insured owner or general contractor when named as a co-defendant in a lawsuit brought for the negligent acts of a hired independent contractor.³⁸

The Manufacturers' and Contractors' Liability Policy is designed to cover the liability insurance needs of a manufacturer or contractor arising out of all business operations as well as the ownership, maintenance, or use of premises.³⁹ This policy type excludes liability coverage for independent contractors employed by the insured. Consequently, under this type of policy, the duty to defend provision is inapplicable for liability arising out of the

32. This type of policy arose out of the defects of the separate policy system that previously existed where the insured had to take out a policy for different types of risks such as automobile liability, premises liability, products liability, etc. See RIEGEL, *supra* note 30, at 443-44.

33. The CGL is subject only to the specific exclusions set forth in the policy. *Id.*

34. *Id.*

35. *Id.* at 442-43.

36. *Id.* at 439-40.

37. *Id.* at 443. This policy type is also known as Independent Contractors' Insurance. *Id.* at 442.

38. *Id.* at 443.

39. *Id.* at 439. A description of the insured's business operations is inserted (listed) in the policy and the premium is based on the payroll, territory, policy limits and exclusions, and the nature of the business operation. *Id.*

use of an independent contractor.⁴⁰ Therefore, a fundamental principle is that there is a direct relationship between the duty to indemnify and the duty to defend.⁴¹

2. *The Nature of the Duty To Defend*

The insurer's duty to defend as established by the standard liability insurance policy provision obligates the insurer to defend the insured and at the same time creates a right in the insurer to exclusive control of the defense.⁴² The exclusive control element is viewed as necessary from a policy standpoint because large sums of money are involved.⁴³ Because insurance premiums are regarded as a "tax on society,"⁴⁴ the insurer's exclusive control has been deemed necessary to minimize unwarranted claims and to ensure an orderly and proper disbursement of funds.⁴⁵

The existence of specific provisions in the standard liability policy obligating an insurer to defend the insured has led to the corollary that the liability policy generally known as indemnity insurance is "litigation insurance" as well.⁴⁶ An insurer is obligated to defend the insured if the facts in the complaint against the insured "raise a reasonable possibility that the insured may be held liable for some act or omission covered by the policy"⁴⁷ This well established rule is the source of the four

40. *Id.*

41. *See supra* text accompanying notes 32-40.

42. *See KEETON, supra* note 16 § 9.1(b), at 988. *See also* *Feliberty v. Damon*, 72 N.Y.2d 112, 527 N.E.2d 261, 531 N.Y.S.2d 778 (1988) (holding that an insurer has an absolute right to control the defense of the insured including the right to settle without seeking the advice of the insured, provided that the settlement is within the policy limits).

43. *APPLEMAN, supra* note 23, § 4681, at 2.

44. *Id.*

45. *Id. See also* *Parker v. Agricultural Ins. Co.*, 109 Misc. 2d 678, 681, 440 N.Y.S.2d 964, 967 (Sup. Ct. 1981) ("Giving the insurer exclusive control over litigation against the insured safeguards the orderly and proper disbursement of the large sums of money involved in the insurance business.").

46. *Seaboard Sur. Co. v. Gillette Co.*, 64 N.Y.2d 304, 310, 476 N.E.2d 272, 275, 486 N.Y.S.2d 873, 876 (1984) ("Though policy coverage is often denominated as 'liability insurance', where the insurer has made promises to defend 'it is clear that [the coverage] is, in fact, 'litigation insurance' as well.'"); *International Paper Co. v. Continental Cas. Co.*, 35 N.Y.2d 322, 326, 320 N.E.2d 619, 621, 361 N.Y.S.2d 873, 876 (1974).

47. *A. Meyers & Sons Corp. v. Zurich Am. Ins. Group*, 74 N.Y.2d 298, 302, 545 N.E.2d 1206, 1208, 546 N.Y.S.2d 818, 820 (1989). *See also* *APPLEMAN, supra* note 23, §

corners of the complaint rule.⁴⁸

3. *Scope of the Duty to Defend*

a. *Allegations in the Complaint*

Under the four corners of the complaint rule, the insurer is often obligated to defend but not to indemnify the insured.⁴⁹ This inconsistency results from the practical reality of when and how the two duties are determined. The duty to defend is determined at the outset of the action and is conditioned on potential coverage under the policy, while the duty to indemnify is determined at the conclusion of the action and is conditioned on legal liability.⁵⁰

The courts have developed rules to guide the insurer in determining whether the duty to defend exists when the allegations of the complaint are compared against the provisions of the insured's policy.⁵¹ First, the duty to defend is conditioned on the possibility of recovery under the policy, not on the probability of recovery.⁵² This rule, by its very nature, broadens the reach of the duty to defend beyond that of the duty to indemnify. Second, if the insurer has a duty to defend with regard to any aspect of the lawsuit, it has a duty to defend every aspect

4683, at 50. The insurer's duty to defend is measured by the allegations in the pleadings; the complaint is compared to the policy to determine if the duty to defend is triggered. *Id.*

48. Other state courts have adopted a very broad rule, the reasonable expectations rule, that obligates an insurer to defend whenever the insured had a reasonable expectation of coverage based on the language of the policy and the allegations of the complaint. *See, e.g.,* Gray v. Zurich Ins. Co., 419 P.2d 168 (Cal. 1966); City of Willoughby Hills v. Cincinnati Ins. Co., 459 N.E.2d 555 (Ohio 1984).

49. *See, e.g.,* Colon v. Aetna Life and Cas. Ins. Co., 66 N.Y.2d 6, 484 N.E.2d 1040, 494 N.Y.S.2d 688 (1985) (holding that the insurer had a duty to defend the insured owner of a vehicle as well as the driver in a personal injury action where the complaint alleged that the driver had the permission of the owner but the jury ultimately concluded at trial that the driver did not have permission, thus failing to give rise to an insurance covered event requiring indemnification).

50. JERRY, *supra* note 22, at 562.

51. *See infra* notes 52-56 and accompanying text.

52. *George Muhlstock & Co. v. American Home Ass'n Co.*, 117 A.D.2d 117, 502 N.Y.S.2d 174 (1st Dep't 1986). The court stated: "The test is not the ultimate proof of the allegations but rather whether sufficient facts are stated so as to invoke coverage under the policy. The duty to defend arises not from the probability of recovery but from its possibility, no matter how remote." *Id.* at 122, 502 N.Y.S.2d at 178.

of the lawsuit.⁵³ Third, when the allegations in the complaint are ambiguous and do not clearly state a claim that is within coverage of the policy, all doubts are resolved in favor of the insured resulting in the insurer having a duty to defend.⁵⁴ Accordingly, an insurer cannot rely on poor complaint drafting to avoid its contractual obligation to defend.⁵⁵ Fourth, in construing insurance policy provisions, courts will resolve any ambiguities in policy wording in favor of the insured.⁵⁶

Pursuant to these judicially developed rules, the duty of an insurer to defend is broader than its duty to indemnify.⁵⁷ However, the insurer's duty to defend is not without limits. For example, the insurer's duty to defend may terminate if the insured has breached some provision of the policy that is unrelated to the allegations of the complaint or the established facts in the

53. See *Ruder & Finn Inc. v. Seaboard Sur. Co.*, 52 N.Y.2d 663, 669-70, 422 N.E.2d 518, 521, 439 N.Y.S.2d 858, 861 (1981) (holding that the duty to defend "includes the defense of those actions in which alternative grounds are asserted, even if some are without the protection purchased").

54. See *International Paper Co. v. Continental Cas. Co.*, 35 N.Y.2d 322, 320 N.E.2d 619, 361 N.Y.S.2d 873 (1974) (holding that although complaint allegations in a personal injury action against insured could be interpreted to refer to an occurrence that (1) took place away from the work premises and (2) that was not within the scope of the insured's employment, which would place the occurrence within a policy exclusion, the insurer was not relieved of its duty to defend absent a demonstration that the allegations were solely and entirely within the policy exclusions). See generally JERRY, *supra* note 22, at 566.

55. *Ruder & Finn*, 52 N.Y.2d at 670, 422 N.E.2d at 521, 439 N.Y.S.2d at 861. The court held that:

[A] policy protects against poorly or incompletely pleaded cases as well as those artfully drafted. Thus the question is not whether the complaint can withstand a motion to dismiss for failure to state a cause of action. Nor is the insured's ultimate liability a consideration. If, liberally construed, the claim is within the embrace of the policy, the insurer must come forward to defend its insured no matter how groundless, false or baseless the suit may be.

Id. See also *Commercial Pipe & Supply Corp. v. Allstate Ins. Co.*, 36 A.D.2d 412, 414-15, 321 N.Y.S.2d 219, 221 (4th Dep't 1971), *aff'd*, 30 N.Y.2d 619, 282 N.E.2d 128, 331 N.Y.S.2d 42 (1972) (holding that the insurer had the duty to defend where the insurance policy covered the unloading of tractor-trailers even when the complaint only alleged that the injury was sustained by cutting wire around a bundle of steel pipes because "it may fairly and reasonably be inferred from the language" that the tractor-trailer was being unloaded).

56. *Ruder & Finn*, 52 N.Y.2d at 671, 422 N.E.2d at 522, 439 N.Y.S.2d at 862 (stating the general rule pertaining to insurance policies "that all ambiguities to the meaning of a policy must be resolved in favor of the insured").

57. *Id.* at 669, 422 N.E.2d at 521, 439 N.Y.S.2d at 861; *Goldberg v. Lumber Mut. Cas. Ins. Co. of N.Y.*, 297 N.Y. 148, 154, 77 N.E.2d 131, 133 (1948).

lawsuit.⁵⁸ In such a situation, although the duty to defend would attach by virtue of the allegations in the complaint, the duty would cease upon the insurer having proved the type of breach that excuses its duty to indemnify.⁵⁹

The duty to defend may also terminate when the insurer undertakes the defense of an ambiguous claim and it later becomes clear that no coverage exists.⁶⁰ The insurer would be entitled to withdraw from the defense as long as the insured would not be prejudiced.⁶¹ This same principle applies to the situation where the claim in the complaint that gave rise to the insurer's duty to defend is subsequently removed from the lawsuit.⁶²

The insurer's duty to defend may also be terminated when the insurer establishes that the allegations in the complaint fall within a policy exclusion.⁶³ In this situation, the insurer cannot rely on the complaint to refuse coverage, but rather must make an affirmative showing that the allegations in the complaint rest "solely and entirely within the policy exclusion, and . . . are subject to no other interpretation."⁶⁴ Therefore, the insurer will only be excused from defending the insured when, in a declaratory judgment action, the court can conclude as a matter of law that the insurer will not be obligated to indemnify the insured.⁶⁵

58. Robert A. Zeavin et al., *How To Handle a Coverage Dispute*; in INTRODUCTION TO BUSINESS INS. LAW AND LITIG. 1985, at 635, 651 (PLI Litig. & Admin. Practice Course Handbook Series No. 296, 1985). Examples of this type of breach include "untimely notice, non-payment of premium, discrepancy between the insured named in the policy and the defendant named in the lawsuit, etc." *Id.*

59. *Id.*

60. See *Lee v. Aetna Cas. & Sur. Co.*, 178 F.2d 750, 753 (2d Cir. 1949) (The rule stated by Judge Hand was "[i]f the plaintiff's complaint against the insured alleged facts which would have supported a recovery covered by the policy, it was the duty of the [insurer] to undertake the defence, until it could confine the claim to a recovery that the policy did not cover.").

61. *Id.* See generally JERRY, *supra* note 22, at 570.

62. *Lee*, 178 F.2d at 753; Barry R. Ostrager et al., *The Insurer's Duty To Defend*, in INSURANCE EXCESS, AND REINSURANCE COVERAGE DISPUTES 1988, at 13, 38-39 (PLI Litig. & Admin. Course Handbook Series No. 343, 1988) (stating that "this limitation on the insurer's duty is widely acknowledged").

63. See *Seaboard Sur. Co. v. Gillette Co.*, 64 N.Y.2d 304, 312, 476 N.E.2d 272, 275, 486 N.Y.S.2d 873, 876 (1984).

64. *Technicon Elecs. Corp. v. American Home Assurance Co.*, 74 N.Y.2d 66, 73-74, 542 N.E.2d 1048, 1050, 544 N.Y.S.2d 531, 533 (1989) (quoting *International Paper Co. v. Continental Ins. Co.*, 35 N.Y.2d 322, 325, 320 N.E.2d 619, 621, 361 N.Y.S.2d 873, 875 (1974)).

65. *Villa Charlotte Bronte, Inc. v. Commercial Union Ins. Co.*, 64 N.Y.2d 846, 848,

The uncertainty of whether the insurer has the duty to defend is in large part due to the modern pleading rules that do not mandate the specificity previously required.⁶⁶ The facts set forth in the pleadings are often insufficient to enable the insurer to make a sound determination of whether the duty to defend exists.⁶⁷ To refuse the insured an insurer-provided defense at the inception of the lawsuit would render the duty to defend provision in the policy meaningless.⁶⁸ Therefore, the courts have developed the liberal rules previously discussed to protect the insured from being denied the contractual right to a defense that would otherwise be unenforceable.⁶⁹ As previously noted, however, the insurer can take steps to relieve itself of the duty to defend under certain circumstances.⁷⁰

b. *Extrinsic Facts*

i. *New York*

The New York courts have also developed rules pertaining to information extrinsic to the complaint that further broaden the insurer's duty to defend. The first rule involves the scenario where the complaint alleges facts sufficient to support a possibility of coverage under the policy, but the insurer knows of facts not mentioned in the complaint that negate its duty to indemnify.⁷¹ In this situation, the insurer is bound by the allegations within the four corners of the complaint and cannot refuse to

476 N.E.2d 640, 641, 487 N.Y.S.2d 314, 315 (1985); *Hanover Ins. Co. v. Sage*, 123 A.D.2d 602, 506 N.Y.S.2d 769 (2d Dep't 1986) (holding that insurer could not be excused from defending insured in a defamation action where there was a factual issue as to whether the defamation claim fell under a policy exclusion because it could not be concluded as a matter of law that there was no possible factual or legal basis on which insurer might eventually be held obligated to indemnify). See also APPLEMAN, *supra* note 23, § 4684.01, at 18 (Supp. 1991).

66. See APPLEMAN, *supra* note 23, § 4684, at 83.

67. *Id.*

68. *Id.* To require the insured to prove the insurer's obligation to defend would be "a return to the old indemnity contracts . . ." *Id.* The author is apparently referring to the type of insurance contracts that were known as single promise policies that only provided for indemnity after the insured has suffered a loss covered by the policy, presumably after judgment or settlement. See Kennedy, *supra* note 3, at 27.

69. See *supra* notes 52-56 and accompanying text.

70. See *supra* notes 57-65 and accompanying text.

71. See JERRY, *supra* note 22, at 565.

defend based on independently obtained information that demonstrates that the claim is in fact not covered.⁷² This rule applies even if the information was obtained directly from the insured.⁷³

The second rule involves the scenario where the allegations in the complaint do not give rise to a duty to defend, but the insurer possesses information that indicates that coverage may exist. There is a paucity of case law in New York involving this situation.⁷⁴ However, two frequently cited cases hold that the insurer must consider facts outside of the complaint that "may fairly and reasonably be inferred from the language [of the complaint]"⁷⁵ and must "be guided, not exclusively by the allegations of the complaint, but also by the facts known to it."⁷⁶

In *Commercial Pipe & Supply Corp. v. Allstate Insurance Co.*,⁷⁷ Commercial Pipe sought to recover its expenses incurred while defending a personal injury action. In the personal injury action, the plaintiff was the driver and owner of a tractor-trailer that he leased to Schreiber Trucking Corporation.⁷⁸ The driver/

72. *Lee v. Aetna Cas. & Sur. Co.*, 178 F.2d 750, 750 (2d Cir. 1949). Judge Hand stated specifically that "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.'" *Id.* at 751. See also *Zurich Am. Ins. Cos. v. Atlantic Mut. Ins. Cos.*, 74 N.Y.2d 621, 539 N.E.2d 1098, 541 N.Y.S.2d 970 (1989) (holding that even though the defendants stated in their answers that they were not covered employees under the policy, the insurer could not use these answers to refuse coverage); *Green Bus Lines v. Consolidated Mut. Ins. Co.*, 74 A.D.2d 136, 144-45, 426 N.Y.S.2d 981, 987 (2d Dep't 1980) (stating that where the insurer is "in possession of certain proof . . . it may not . . . [use it to] resolve ambiguities in the . . . complaint . . .").

73. *Kinkaid v. Simmons*, 66 A.D.2d 428, 414 N.Y.S.2d 407 (1st Dep't 1979) (holding that insurer had duty to defend despite insured's admission that the accident occurred after completion of work that placed the accident within the completed hazard exclusion because the complaint alleged that the accident occurred prior to completion).

74. Other jurisdictions have more developed case law in this area. See *infra* notes 98-112 and accompanying text.

75. *Commercial Pipe & Supply Corp. v. Allstate Ins. Co.*, 36 A.D.2d 412, 415, 321 N.Y.S.2d 219, 221 (4th Dep't 1971).

76. *Sucrest Corp. v. Fisher Governor Co.*, 83 Misc. 2d 394, 403, 371 N.Y.S.2d 927, 937 (Sup. Ct. 1975). There are cases in New York that cite *Commercial Pipe* and *Sucrest*, purporting to consider extrinsic information in determining the duty to defend, but which ultimately make a determination based simply on the potentiality of the allegations in the complaint rather than on consideration of extrinsic information. See, e.g., *Ogden Corp. v. Travelers Indem. Co.*, 681 F. Supp. 169 (S.D.N.Y. 1988).

77. 36 A.D.2d 412, 321 N.Y.S.2d 219 (4th Dep't 1971).

78. *Id.* at 413, 321 N.Y.S.2d at 220.

owner was injured while unloading steel pipe that was intended for delivery to Commercial Pipe.⁷⁹ The driver/owner brought suit against Commercial Pipe alleging that its employees negligently cut a wire around a bundle of steel pipes causing them to become loose and injure him.⁸⁰ Commercial Pipe claimed that it was a named insured under the automobile policy that Schreiber Trucking Corporation held with Allstate.⁸¹ The policy provided that "also included as an insured [are] any person[s] [] using an owned or hired automobile . . . provided that such use includes the loading and unloading thereof."⁸² Upon receiving the complaint, Commercial Pipe tendered it to Allstate with a letter stating that because the accident occurred while unloading the tractor-trailer, it was an additional insured under Schreiber's policy and therefore, entitled to a defense.⁸³

Allstate refused to defend, basing its refusal on the fact that the complaint stated only that the injury was "caused by negligence of [Commercial Pipe's] employees in cutting wire around a bundle of steel pipes."⁸⁴ The court held that Allstate had a duty to defend because, although the complaint did not specifically state that the incident occurred while unloading, "it may fairly and reasonably be inferred from the language [of the complaint]" that the injury occurred during unloading.⁸⁵ The court further stated that "the language of the complaint need not state all the facts requisite to establish insurance coverage," but only facts sufficient to bring the claim within the potential coverage of the policy.⁸⁶

79. *Id.* Although the shipment was intended for delivery to Commercial Pipe, it was mistakenly delivered next door to Acme Nipple Manufacturing Company whose employees helped unload the steel pipe. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.* at 414, 321 N.Y.S.2d at 221.

85. *Id.* at 415, 321 N.Y.S.2d at 221.

86. *Id.* This case appears to provide only tenuous support for the rule that the citing cases use it for — that information extrinsic to the complaint must be used to determine the insurer's duty to defend. The court here allowed a logical inference from the facts alleged in the complaint that brought the claim potentially within the coverage of the policy — that the cutting of the wire around the bundle of pipes in connection with the defendants delivering those pipes to the plaintiff necessarily involved the unloading of the pipes. This logical inference is far removed from inferring, for instance, that a

In the second frequently cited case, *Sucrest Corp. v. Fisher Governor Co.*,⁸⁷ Fisher, as a fourth-party plaintiff, sought a declaratory judgment that a CGL policy issued by Liberty Mutual Insurance Company (Liberty) to Scovill Manufacturing Company (Scovill) "afforded coverage to Fisher under a vendor's or product's liability endorsement to the policy."⁸⁸ The complaint allegations in the underlying action charged Fisher with negligence in connection with the manufacture, distribution and sale of a special shut-off valve that allegedly caused a fire at Sucrest's refinery.⁸⁹ After receipt of the complaint, Fisher commenced a third-party action against Scovill for indemnity, charging that any damages it might be liable for were caused by the negligence of Scovill because it had sold the valve to Fisher.⁹⁰

Scovill's CGL policy contained a vendor's or product's liability endorsement extending coverage "to any person or organization with respect to the distribution or sale in the course of business of any merchandise or product manufactured, sold, handled or distributed by the named insured."⁹¹ Fisher claimed it was an additional insured under Scovill's endorsement policy and sought to recover the defense costs that it had incurred in the underlying action.⁹² Liberty refused to defend Fisher, asserting that the allegations in the original complaint were insufficient to invoke coverage for Fisher. Liberty further stated that neither the original complaint nor the supplemental complaint served on Fisher named Scovill as a defendant.⁹³

The court held that Liberty did have a duty to defend Fisher, but only after Liberty was put on notice of its liability,

third-party not mentioned in the pleading had performed the act. *See also infra* text accompanying notes 305-07.

87. 83 Misc. 2d 394, 371 N.Y.S.2d 927 (Sup. Ct. 1975).

88. *Id.* at 396, 371 N.Y.S.2d at 931-32. Fisher claimed that Liberty had the duty to indemnify it for the settlement that it made with Sucrest in the main action prior to instituting this action. *Id.*, 371 N.Y.S.2d at 932.

89. *Id.* at 397, 371 N.Y.S.2d at 932.

90. *Id.*

91. *Id.* at 398, 371 N.Y.S.2d at 933.

92. *Id.* at 396, 371 N.Y.S.2d at 932. In addition, Fisher sought recovery for the defense costs it incurred in prosecuting the declaratory judgment action which was denied by the court. *Id.* *See infra* notes 171-75 and accompanying text for a discussion of when attorney's fees are recoverable in breach of duty to defend situations.

93. *Id.* at 401, 371 N.Y.S.2d at 936.

that is, when Fisher served the third-party complaint on its named insured, Scovill.⁹⁴ The court stated that Liberty should have examined both the supplemental complaint served on Fisher and the third-party complaint against its insured to determine whether it had a duty to defend Fisher as an additional insured in the original action.⁹⁵ The court held that because the allegations in the third-party complaint were sufficient to raise the possibility that Fisher would be covered under the endorsement to Scovill's policy, it had a duty to defend Fisher from that time forward.⁹⁶ In conclusion, the court held that "where the complaint alleges facts without the coverage of the policy, but the carrier [insurer] has knowledge of facts indicating coverage, the insurer is to be guided, not exclusively by the allegations of the complaint, but also by the facts known to it."⁹⁷

ii. *Other Jurisdictions*

The consideration of extrinsic information in the duty to defend determination has been accepted in many jurisdictions.⁹⁸ These jurisdictions have expanded or modified the four corners of the complaint rule to include consideration of facts not contained in the complaint.⁹⁹ The modifications of the rule fall into two basic categories. The first category only requires consideration of facts "actually known" by the insurer.¹⁰⁰ The second requires consideration of those extrinsic facts that are known or

94. *Id.*

95. *Id.* at 401-02, 371 N.Y.S.2d at 936.

96. *Id.* However, in its final decision the court only obligated Liberty to pay the defense costs from the date it formally refused to defend Fisher, March 16, 1973, one month after service of the third-party complaint. *Id.* at 408, 371 N.Y.S.2d at 942. The court also held that Liberty was under a duty to indemnify Fisher for the settlement that it had made with Sucrest in the underlying action of \$265,000. *Id.*

97. *Id.* at 403, 371 N.Y.S.2d at 937. The court here seems to be stating that the insurer must also look at facts in other "complaints" to determine the duty to defend. It is not clear whether the court meant that an insurer has a duty to look at facts known from other sources. See *infra* text accompanying notes 305-10.

98. See *infra* notes 100-01.

99. See *infra* text accompanying notes 102-09.

100. See, e.g., *La Rotunda v. Royal Globe Ins. Co.*, 408 N.E.2d 928 (Ill. App. Ct. 1980); *New Hampshire Ins. Co. v. Christy*, 200 N.W.2d 834 (Iowa 1972); *Shepard Marine Constr. Co. v. Maryland Cas. Co.*, 250 N.W.2d 541 (Mich. 1977); *Lanoue v. Fireman's Fund Am. Ins. Co.*, 278 N.W.2d 49 (Minn. 1979).

"reasonably ascertainable."¹⁰¹

Those jurisdictions that only require an insurer to consider facts "actually known" do not require the insurer to investigate the claim.¹⁰² Rather, the insurer is only obligated to consider those extrinsic facts made known to it by the insured,¹⁰³ by the insurer's own voluntary investigation,¹⁰⁴ or by other means.¹⁰⁵

In contrast, the jurisdictions that require an insurer to consider those extrinsic facts known or reasonably ascertainable also require the insurer to investigate the claim.¹⁰⁶ These states impose an affirmative duty on the insurer to make a reasonable investigation.¹⁰⁷ After investigation, the insurer is obligated to consider the facts in the complaint, express and implied, and those facts that it learns of from its investigation, its insured, and other sources.¹⁰⁸ The insurer must provide a defense, if the facts it has knowledge of, if proved, would require the insurer to indemnify the insured.¹⁰⁹ Therefore, the four corners of the complaint rule in these jurisdictions is treated as a valid inclusionary standard but not a valid exclusionary standard.¹¹⁰ Accordingly, the complaint allegations are not dispositive if the insurer learns

101. See, e.g., *Evan v. Employer's Mut. Liab. Ins. Co.*, 391 F. Supp. 1230 (D. Alaska 1975); *Fresno Economy Import Used Cars v. United States Fid. & Guar. Co.*, 142 Cal. Rptr. 681 (Cal. Ct. App. 1978); *Loftin v. United States Fire Ins. Co.*, 127 S.E.2d 53 (Ga. Ct. App. 1962); *Patrons Mut. Ins. Ass'n v. Harmon*, 732 P.2d 741 (Kan. 1987); *Marshall's U.S. Auto Supply v. Maryland Cas. Co.*, 189 S.W.2d 529 (Mo. 1945).

102. See *infra* notes 103-05 and accompanying text.

103. See *Lanoue v. Fireman's Fund Am. Ins. Co.*, 278 N.W.2d 49 (Minn. 1979) (holding that insurer was obligated to defend where insured informed insurer of facts placing claim within coverage).

104. See *La Rotunda v. Royal Globe Ins. Co.*, 408 N.E.2d 928 (Ill. App. Ct. 1980) (holding that the insurer was obligated to defend where facts obtained through its own investigation put claim within policy coverage).

105. See *Shepard Marine Constr. Co. v. Maryland Cas. Co.*, 250 N.W.2d 541 (Mich. 1977) (holding that the insurer was required to defend where facts stipulated by the parties fell within coverage of policy).

106. *Fresno Economy Import Used Cars v. United States Fid. & Guar. Co.*, 142 Cal. Rptr. 681, 685 (Cal. Ct. App. 1978).

107. See *Patrons Mut. Ins. Ass'n v. Harmon*, 732 P.2d 741, 744 (Kan. 1987); *Marshall's U.S. Auto Supply v. Maryland Cas. Co.*, 189 S.W.2d 529, 531 (Mo. 1945).

108. *Fresno*, 142 Cal. Rptr. at 685.

109. See, e.g., *Loftin v. United States Fire Ins. Co.*, 127 S.E.2d 53 (Ga. Ct. App. 1962) (holding that the insurer was required to defend the insured based on facts ascertainable by investigation that placed claim within the coverage of the policy).

110. See *JERRY*, *supra* note 22, at 564. This means that the triggering of the insurer's duty to defend is not limited to the allegations in the complaint. See *id.*

from extrinsic information, either from an investigation or otherwise, that the possibility of coverage exists.¹¹¹ Proponents argue that the logic behind this rule is unassailable — that an insurer should not be permitted to evade its contractual obligation to defend by ignoring the true facts and instead rely on erroneous or mistaken allegations in the complaint, or on a complaint which lacks certain factual allegations that describe an event covered under the insurance policy.¹¹² In sum, these jurisdictions impose on the insurer an affirmative duty to look beyond the complaint when determining whether the duty to defend has been triggered.

B. *An Insured's Request For Defense: Standard Procedure*

1. *Insured's Responsibilities*

Initially, "[t]he insured has the burden of proving that the claim asserted comes within the coverage of the policy."¹¹³ This burden is generally satisfied by tendering to the insurer a complaint which contains facts and allegations that create a reasonable possibility of coverage.¹¹⁴ In addition, the insured must fully cooperate with the insurer.¹¹⁵ Once the insured has shown the possible existence of the right to indemnity under the policy, the

111. *Id.*

112. See WINDT, *supra* note 27, § 4.03, at 137.

113. *Id.* § 4.01, at 130; *Commercial Union Ins. Co. v. Albert Pipe & Supply Co.*, 484 F. Supp. 1153, 1155 (S.D.N.Y. 1980).

114. See *supra* notes 51-57 and accompanying text.

115. Under the standard CGL policy, an insured is required to cooperate with the insurer once a claim has been made. Carolyn P. Perry, *The Obligations of the Parties - Conditions Precedent and Subsequent*, 1 INT'L RISK MGMT. INST. 515-B (1986). A CGL policy is a conditional contract with conditions precedent (those conditions that must be met to trigger the insurer's promises), and conditions subsequent (an action by the insured that extinguishes the insurer's promises in the insurance contract). *Id.* An insured's failure to cooperate is a condition subsequent. *Id.* An insured's fraud or material misrepresentation in making a claim constitutes a failure to cooperate, a condition subsequent, which therefore acts to relieve the insurer of its promise to indemnify the insured. *Id.* at 515-E. See, e.g., *Nationwide Mut. Ins. Co. v. Erie Basin Carting Co.*, 68 Misc. 2d 17, 325 N.Y.S.2d 35 (Sup. Ct. 1971), *modified on other grounds sub nom.*, *Mastrangelo v. Strype*, 39 A.D.2d 922, 332 N.Y.S.2d 923 (2d Dep't 1972) (holding that the insurer was entitled to disclaim liability under policy when insured breached cooperation clause by making false statement in claim); *Sweet v. United States Fire Ins. Co.*, 72 Misc. 2d 1022, 340 N.Y.S.2d 957 (Civ. Ct. 1973) (stating that the duty to cooperate was violated when insured willfully misstated material facts in claim).

insured is entitled to an insurer-provided defense.

2. *Insurer's Responsibilities and Options*

Upon receiving the complaint, the insurer is on notice of its potential contractual duties.¹¹⁶ The insurer must then make the often difficult decision of whether it has the duty to defend the insured under the four corners of the complaint rule.¹¹⁷ The long established standard by which this determination has been made is to compare the allegations in the complaint with the terms of the policy.¹¹⁸ After comparison, the insurer has several options to consider. The insurer may deny coverage, seek rescission of the policy or defend its insured.

a. *Denying Coverage*

The insurer may deny coverage to the insured on the ground that the claim is not covered under the policy.¹¹⁹ The insurer will be justified in denying coverage if the allegations in the complaint clearly fail to assert any claim for which the insurer might be required to indemnify the insured.¹²⁰ If an insurer chooses to deny coverage, it must adhere to the statutory requirements set forth in Insurance Law § 3420(d) which provides that "[i]f under a liability policy . . . an insurer shall disclaim liability or deny coverage for . . . any other type of accident occurring within this state, it shall give written notice as soon as is reasonably possible . . . to the insured and the injured person or any other claimant."¹²¹ Written notice must be timely,¹²² and specific as to the grounds relied upon.¹²³

116. JERRY, *supra* note 22 at 569. See also *Sucrest Corp. v. Fisher Governor Co.*, 83 Misc. 2d 394, 401, 371 N.Y.S.2d 927, 936 (Sup. Ct. 1975) (holding that insurer was put on notice of its liability when complaint was served on insured and tendered to insurer).

117. See *Technicon Elecs. Corp. v. American Home Assurance Co.*, 74 N.Y.2d 66, 73, 542 N.E.2d 1048, 1050, 544 N.Y.S.2d 531, 533 (1989).

118. *Id.*

119. See *Henderson v. Aetna Cas. and Sur. Co.*, 55 N.Y.2d 947, 434 N.E.2d 247, 449 N.Y.S.2d 178 (1982).

120. *Id.*

121. N.Y. INS. LAW § 3420(d) (McKinney 1985).

122. See *Hartford Ins. Co. v. County of Nassau*, 46 N.Y.2d 1028, 389 N.E.2d 1061, 416 N.Y.S.2d 539 (1979) (holding that whether written notice is in fact timely is generally considered a question of fact).

123. See *General Accident Ins. Group v. Cirucci*, 46 N.Y.2d 862, 864, 387 N.E.2d

Even though the insurer may have properly denied coverage initially, this does not mean that the duty to defend cannot subsequently arise.¹²⁴ For example, if the complaint is amended or certain facts indicating coverage are disclosed during discovery, the duty to defend may still attach.¹²⁵ In this situation, the initial burden is again on the insured to prove that the claim is within coverage of the policy.¹²⁶

b. *Seeking Rescission*

The insurer may seek rescission of the policy if it determines that the policy was obtained through fraud, misrepresentation, concealment of material facts or mutual mistake of fact.¹²⁷ In this situation, the duty to defend issue would arise only if the insurer's rescission efforts were to fail.

c. *Defending*

If, after comparison of the complaint and the policy, the insurer determines that there is a potential duty to indemnify the insured, it must undertake the defense of the action.¹²⁸ If there is uncertainty regarding its duty to defend, the insurer should assume the defense of the insured under a reservation of rights to avoid the risk of breaching its contractual duty.¹²⁹ This allows the insurer to protect itself and the insured until further investigation reveals whether coverage exists.¹³⁰

223, 225, 414 N.Y.S.2d 512, 514 (1979) (holding that insurer's denial of coverage must be specific; waiver of all defenses cannot be achieved by a broad unilateral statement by insurer).

124. *Sucrest Corp. v. Fisher Governor Co.*, 83 Misc. 2d 394, 401, 371 N.Y.S.2d 927, 936 (Sup. Ct. 1975).

125. *See id.* (the insurer's duty arose after commencement of the underlying action by service of a third-party complaint); *Lee v. Aetna Cas. & Sur. Co.*, 178 F.2d 750, 752-53 (2d Cir. 1949). *See generally* WINDT, *supra* note 27, § 4.08, at 149-50.

126. *See supra* notes 113-14 and accompanying text.

127. *ROBERT F. CUSHMAN ET AL., PROSECUTING AND DEFENDING INSURANCE CLAIMS* § 2.28, at 73 (1989).

128. *Technicon Elecs. Corp. v. American Home Assurance Co.*, 74 N.Y.2d 66, 73, 542 N.E.2d 1048, 1050, 544 N.Y.S.2d 531, 533 (1989).

129. *See CUSHMAN, supra* note 127, § 2.28, at 73. *See also infra* notes 178-93 and accompanying text for a discussion of reservation of rights.

130. *See CUSHMAN, supra* note 127, § 2.28, at 73.

C. *The Four Corners of the Complaint Rule: Pre-Fitzpatrick*

1. *Advantages and Disadvantages*

Under the four corners of the complaint rule, the comparison of the complaint and the policy is an objective, efficient and certain test that allows for an immediate determination in most circumstances.¹³¹ This rule is logical, practical and easy to apply.¹³² Its objective nature provides for an easily reviewable determination on appeal. Using this rule, the insurer need only make a determination based upon the two documents before it.¹³³ If the insured challenges the insurer's determination in a declaratory judgment action, the court can base its ruling on the same two documents.¹³⁴

Under a strict application of this rule, the insured may be denied its contracted-for defense in some instances. This may occur in those situations where the complaint fails to allege certain material facts that describe an event covered under the insured's policy or alleges incorrect facts. This seemingly harsh result may be *de minimis* because modern pleading rules permit the pleadings to be amended at any time to conform to the evidence elicited during discovery or at trial.¹³⁵

As a practical matter, this rule in its strict application does not create any duty to investigate on the part of the insurer.¹³⁶ A "no duty to investigate" scheme has advantages and disadvantages for both the insurer and the insured. The insurer has the advantage of an objective test and is saved the increase in operating costs associated with investigation.¹³⁷ On the other hand, because of the judicially developed rules to determine whether the duty to defend exists under the four corners of the complaint rule, the insurer is often forced to assume the defense of

131. See Garbett, *supra* note 1, at 241-42.

132. See *id.* at 241.

133. See *A. Meyers & Sons Corp. v. Zurich Am. Ins. Group*, 74 N.Y.2d 298, 302, 545 N.E.2d 1206, 1208, 546 N.Y.S.2d 818, 820 (1989).

134. *Id.*

135. See N.Y. CIV. PRAC. L. & R. 3025 (McKinney 1991).

136. See *supra* note 133 and accompanying text.

137. See WINDT, *supra* note 27, § 4.06, at 147-48. Under a duty to investigate scheme, "an insurer would have to undertake a thorough investigation in all cases in which a complaint did not contain averments specifically disproving coverage." See *id.* at 148.

many claims that it would not otherwise undertake.¹³⁸ The disadvantage for the insured is that in some instances the insured is unfairly denied coverage, which is usually only temporary, because the plaintiff controls the allegations set forth in the complaint.¹³⁹ The insured often benefits by being provided with a defense because of the liberal interpretation of the four corners of the complaint rule.¹⁴⁰ Furthermore, where the insurer is not obligated to spend its resources on investigation, the insured presumably benefits by paying a lower premium.

2. *Consequences of an Insurer's Refusal to Defend*

When the insurer makes the determination to deny coverage and not provide a defense, it does so at its own peril and must bear the consequences if its decision is wrong.¹⁴¹ This determination may result in a justified or unjustified refusal.¹⁴² If the insurer's refusal is justified, there is no breach of contract and the insurer incurs no legal liability.¹⁴³ Where the insurer makes a good faith but unjustifiable refusal to defend the insured, a material breach of contract results and the insurer is liable to the insured for damages caused by the breach.¹⁴⁴

138. See *supra* notes 51-57 and accompanying text.

139. The facts as alleged by the insured would be revealed in pre-trial discovery and the plaintiff could amend the pleading to conform to the newly discovered evidence. See N.Y. CIV. PRAC. L. & R. 3025 (McKinney 1991).

140. See *supra* notes 51-57 and accompanying text.

141. See *McGroarty v. Great Am. Ins. Co.*, 36 N.Y.2d 358, 329 N.E.2d 172, 368 N.Y.S.2d 485 (1975).

142. See generally WINDT, *supra* note 27, §§ 4.08, 4.09, 4.31.

143. *A. Meyers & Sons Corp. v. Zurich Am. Ins. Group*, 74 N.Y.2d 298, 545 N.E.2d 1206, 546 N.Y.S.2d 818 (1989) (holding that insurer justifiably refused to defend insured where allegations in the complaint of patent infringement did not fall within the insured's policy covering any injury arising out of advertising activity and therefore did not breach its duty to defend); *Technicon Elecs. Corp. v. American Home Assurance Co.*, 74 N.Y.2d 66, 542 N.E.2d 1048, 544 N.Y.S.2d 531 (1989).

144. Existing in every contract is an implied covenant of good faith and fair dealing. *Gordon v. Nationwide Mut. Ins. Co.*, 30 N.Y.2d 427, 437, 285 N.E.2d 849, 854, 334 N.Y.S.2d 601, 608 (1972), *cert. denied*, 410 U.S. 931 (1973). A good faith refusal exists when the insurer makes an honest mistake or an erroneous assumption that the claim is outside policy coverage. See *id.*, 285 N.E.2d at 854, 334 N.Y.S.2d at 609. See generally JERRY, *supra* note 22, at 576; WINDT, *supra* note 27, § 4.31, at 202. The importance of a "good faith unjustifiable breach" determination (versus a "bad faith unjustifiable breach") is that the insurer is liable in damages only up to the policy limits. See *infra* notes 157-60 and accompanying text.

Consequently, the insured is no longer obligated to perform its respective duties under the contract.¹⁴⁵ The insured is thereby excused from the claims processing requirements and from the duty to cooperate with the insurer.¹⁴⁶ Furthermore, the insurer loses the right to control the defense¹⁴⁷ and may not intervene in the action to prohibit settlement by the insured.¹⁴⁸

The duty to defend is contractual,¹⁴⁹ therefore, the insured can recover compensatory damages for the breach, which include consequential damages.¹⁵⁰ Compensatory damages recoverable by the insured include reasonable attorney fees and costs expended for the defense of the action.¹⁵¹ The insured may also recover any reasonable settlement that the insured has paid where the insurer's refusal to defend was unjustified.¹⁵² This holds true even where the policy prohibits settlements without the insurer's consent.¹⁵³ The insurer, however, is not obligated to pay the insured for a settlement made without its consent unless it had a duty to indemnify.¹⁵⁴ Accordingly, it is possible that the insured may recover defense costs but not money paid as a settlement.¹⁵⁵ In addition, the insured may recover consequential

145. See JERRY, *supra* note 22, at 584.

146. *Id.*

147. *Isadore Rosen & Sons, Inc. v. Security Mut. Ins. Co.*, 31 N.Y.2d 342, 291 N.E.2d 380, 339 N.Y.S.2d 97 (1972).

148. *Cardinal v. State*, 304 N.Y. 400, 107 N.E.2d 569, *remittitur denied*, 304 N.Y. 875, 109 N.E.2d 885 (1952); *cert. denied*, 345 U.S. 918 (1953).

149. *International Paper Co. v. Continental Cas. Co.*, 35 N.Y.2d 322, 325, 320 N.E.2d 619, 621, 361 N.Y.S.2d 873, 875 (1974) (stating that "[a]n insured's right to be accorded legal representation is a contractual right . . .").

150. See generally JERRY, *supra* note 22 at 561; APPLEMAN, *supra* note 23, § 4689, at 207.

151. *Commercial Pipe & Supply Corp. v. Allstate Ins. Co.*, 30 N.Y.2d 619, 282 N.E.2d 128, 331 N.Y.2d 42 (1972) (awarding insured defense costs plus interest where insurer unjustifiably refused to defend).

152. See APPLEMAN, *supra* note 23, § 4690, at 222.

153. *Sucrest Corp. v. Fisher Governor Co.*, 83 Misc. 2d 394, 405-06, 371 N.Y.S.2d 927, 940 (Sup. Ct. 1975) (stating that "it is well settled that where an insurer unjustifiably refuses to defend, the insured may make a reasonable settlement . . . and will thereafter be entitled to reimbursement from the carrier, despite the fact that the policy purports to avoid liability for settlements made without the insurer's consent.").

154. *Servidone Constr. Corp. v. Security Ins. Co.*, 64 N.Y.2d 419, 423, 477 N.E.2d 441, 444, 488 N.Y.S.2d 139, 142 (1985) (holding that an insurer's breach of duty to defend does not create coverage and there can be no duty to indemnify unless there is a covered loss).

155. *Id.*

damages.¹⁵⁶

Absent proof of bad faith, an insurer that breached its duty to defend is liable only up to the policy limit.¹⁵⁷ Any amount in excess of the policy limit sought by the insured would constitute punitive damages and could only be recovered if the insured showed bad faith on the part of the insurer.¹⁵⁸ In *Gordon v. Nationwide Mutual Insurance Co.*,¹⁵⁹ the New York Court of Appeals held that to constitute a breach of the implied covenant of good faith in denying coverage "more than an 'arguable case' of coverage responsibility must be shown" that would evidence a "gross disregard for [the] policy obligation."¹⁶⁰

3. *Insurer's Alternatives When the Duty to Defend is Unclear*

When an insurer encounters a situation in which it is uncertain whether the duty to defend has been triggered, the insurer has options from which to choose to prevent the possibility of breach of contract and to protect its interests.¹⁶¹

a. *Declaratory Judgment Action*

The insurer may use the declaratory judgment action¹⁶² to determine the duty to defend issue.¹⁶³ The declaratory judgment is a beneficial tool for the insurer in two situations. First, the insurer may use this tool where the issue that is determinative of

156. See generally JERRY, *supra* note 22 at 576. Consequential damages are any damages incurred as a result of the breach that: (1) are foreseeable at the time of the breach and (2) flow naturally from the breach. See *Hadley v. Baxendale*, 156 Eng. Rep. 145 (1854). Interest paid on a loan to pay for defense costs is a typical example of a consequential damage in this situation. See WINDT, *supra* note 27, § 4.32, at 204.

157. *United States Fid. and Guar. Co. v. Copfer*, 48 N.Y.2d 871, 400 N.E.2d 298, 424 N.Y.S.2d 356 (1979).

158. *Id.* at 873, 400 N.E.2d at 298-99, 424 N.Y.S.2d at 357.

159. 30 N.Y.2d 427, 285 N.E.2d 849, 334 N.Y.S.2d 601 (1972), *cert. denied*, 410 U.S. 931 (1973). The court held that bad faith "requires an extraordinary showing of disingenuous or dishonest failure to carry out a contract." *Id.* at 437, 285 N.E.2d at 854, 334 N.Y.S.2d at 609.

160. *Id.* at 431, 285 N.E.2d at 850-51, 334 N.Y.S.2d at 603-04.

161. See *infra* notes 162-93 and accompanying text.

162. See N.Y. CIV. PRAC. L. & R. 3001 (McKinney 1991). A declaratory judgment action is an action that asks the court to declare or establish the rights of the parties before it in a particular subject matter. See *id.* at cmt. C3001:1.

163. APPLEMAN, *supra* note 23, § 4686, at 171-75.

coverage is unrelated to the factual issues of the lawsuit itself.¹⁶⁴ Second, the insurer may use the declaratory judgment action to determine if the duty to defend exists where the facts in the lawsuit are not in dispute.¹⁶⁵ The insurer would use the action to move for summary judgment to determine if the duty has been triggered.¹⁶⁶

The insurer may not use the declaratory judgment action to resolve a factual issue that determines coverage if that factual issue will be litigated in the underlying lawsuit itself.¹⁶⁷ There are several reasons asserted for this principle. First, to try the issue(s) preliminarily in a declaratory action would result in unnecessary litigation.¹⁶⁸ Second, if the plaintiff in the underlying action is joined as a party in the declaratory judgment action, it would be prejudicial to him to be collaterally estopped from re-litigating the same issue(s) in the underlying action.¹⁶⁹ Third, where the plaintiff in the underlying action is not joined, the same issues may be litigated twice, resulting in judicial inefficiency and unfairness to the insured.¹⁷⁰

164. See Zeavin, *supra* note 58, at 678-79. For example, a declaratory judgment action may be used if the insurer asserts that the insured did not give timely notice of the claim, failed to pay the premium to invoke coverage, canceled the insurance, made a material misrepresentation in applying for the policy, or breached the policy in some other way. *Id.* See also *Van Wyck Assocs. v. St. Paul Fire & Marine Ins. Co.*, 115 Misc.2d 447, 454 N.Y.S.2d 266 (Sup. Ct. 1982), *aff'd without op.*, 95 A.D.2d 989, 464 N.Y.S.2d 617 (2d Dep't), *appeal denied*, 60 N.Y.2d 559, 458 N.E.2d 1261, 470 N.Y.S.2d 1025 (1983) (insurer employed use of declaratory judgment action to determine that it did not have a duty to defend or indemnify where insured had canceled policy prior to date of injury alleged in the complaint).

165. See Zeavin, *supra* note 58, at 679.

166. *Id.*

167. *Allstate Ins. Co. v. Santiago*, 98 A.D.2d 608, 469 N.Y.S.2d 343 (1st Dep't 1983) (holding that the issue of whether employee was driving employer's vehicle with permission is a question of fact to be determined in the underlying action and therefore is not appropriate for a declaratory judgment action brought by the employer's insurer). In *Colon v. Aetna Life and Cas. Ins. Co.*, 66 N.Y.2d 6, 484 N.E.2d 1040, 494 N.Y.S.2d 688 (1985), the New York Court of Appeals made an exception to this principle. The court held that even if the issue may be litigated in the underlying action, if "the issue is clearcut, the . . . insurer should be entitled to obtain a prompt judicial determination, whether by summary judgment, declaratory judgment or otherwise that, contrary to the allegations of the . . . complaint, . . . the insurer is not obligated . . . to furnish a defense . . ." *Id.* at 10, 484 N.E.2d at 1042, 494 N.Y.S.2d at 690.

168. See *Aetna Cas. and Sur. Co. v. Lauria*, 54 A.D.2d 183, 185, 388 N.Y.S.2d 432, 435 (4th Dep't 1976).

169. See Zeavin, *supra* note 58, at 681.

170. *Id.*

When a declaratory judgment action is brought to determine whether the insurer's duty to defend has been triggered, the question arises as to who is responsible for the legal costs of the action.¹⁷¹ New York courts adhere to the general rule followed by most American courts that any party bringing an action to settle his rights must be responsible for the costs of bringing such action.¹⁷² Accordingly, if the insured brings the action to determine or enforce the duty to defend, the insured cannot recover the costs.¹⁷³ However, if the insurer brings the action and casts the insured in a defensive posture, the insured may recover the defense costs in the declaratory judgment action¹⁷⁴ provided that the insured is ultimately found to have coverage.¹⁷⁵

Therefore, when available, the use of the declaratory judgment action allows the insurer to avoid the risk of breach,¹⁷⁶ and if the insurer prevails, also to avoid the cost of the defense in the underlying action. Although a seemingly attractive option, use of a declaratory judgment action has some possible disadvantages: (1) the proceeding may not be immediately available; (2) the discovery process may aid the adverse party in the underlying action and therefore affect the settlement process if reached; (3) the insurer will be liable for all of the attorney's fees for both parties in the action if it loses; and (4) the insured is likely to become a hostile adversary as a result of the action.¹⁷⁷

171. *Mighty Midgets v. Centennial Ins. Co.*, 47 N.Y.2d 12, 21-22, 389 N.E.2d 1080, 1085, 416 N.Y.S.2d 559, 564 (1979).

172. *Id.*

173. *Id.*

174. See *Ostrager*, *supra* note 62, at 82; *Schwamb v. Fireman's Ins. Co.*, 41 N.Y.2d 947, 949, 363 N.E.2d 356, 357, 394 N.Y.S.2d 632, 633 (1977).

175. *Commercial Union Ins. Co. v. International Flavors & Fragrances, Inc.* 822 F. Supp. 267 (2d Cir. 1987) (holding that insured was not entitled to legal costs to defend declaratory judgment action where insurer found not obligated to indemnify the insured); *Brown v. United States Fid. and Guar. Co.*, 46 A.D.2d 97, 361 N.Y.S.2d 232 (3d Dep't 1974).

176. Also avoided are the risk of waiver and estoppel. See *infra* notes 181-83 and accompanying text.

177. See *JERRY*, *supra* note 22 at 609.

b. *Reservation of Rights*

In cases where a declaratory judgment action is either inappropriate or not immediately available, the insurer can protect itself by assuming the defense of the insured under a reservation of rights.¹⁷⁸ By taking this step, the insurer preserves its right to raise coverage issues as the lawsuit progresses.¹⁷⁹ This is a better approach than (1) outright denial of coverage with the attendant possibility of breach of contract, or (2) assuming full defense without protection from waiver or estoppel.¹⁸⁰

Should the insurer assume a defense and fail to reserve its rights, it runs the risk that the insured will use the doctrines of waiver and/or estoppel to preclude the insurer from later raising coverage defenses. The doctrine of waiver is based on the premise that an insurer, having assumed a defense, has waived the right to claim that coverage does not exist.¹⁸¹ The doctrine of estoppel can also be invoked by the insured to prevent an insurer from subsequently asserting a coverage defense, but requires prejudicial or detrimental reliance by the insured in response to the insurer's conduct.¹⁸² The doctrines of waiver and estoppel, however, cannot create coverage where none existed under the policy initially.¹⁸³ Therefore, absent an outright denial of policy coverage when no waiver question exists, the insurer should reserve its rights to later assert coverage defenses.¹⁸⁴

The reservation of rights can take the form of either a non-waiver agreement or a reservation of rights notice.¹⁸⁵ A non-

178. See *infra* notes 185-90 and accompanying text.

179. See CUSHMAN, *supra* note 127, § 2.28, at 73.

180. *Id.*

181. See *General Accident Ins. Group v. Cirucci*, 46 N.Y.2d 862, 387 N.E.2d 223, 414 N.Y.S.2d 512 (1979).

182. *Albert J. Schiff Assocs. v. Flack*, 51 N.Y.2d 692, 417 N.E.2d 84, 435 N.Y.S.2d 972 (1980). An insured could assert the doctrine of equitable estoppel where an insurer, "though not in fact obligated to provide coverage, without asserting policy defenses or reserving the privilege to do so, undertakes the defense of the case, in reliance on which the insured suffers the detriment of losing the right to control his own defense." *Id.* at 699, 417 N.E.2d at 87, 435 N.Y.S.2d at 975.

183. See *Zappone v. Home Ins. Co.*, 55 N.Y.2d 131, 432 N.E.2d 783, 447 N.Y.S.2d 911 (1982). In addition, the insurer can only waive or be estopped from denying defenses to policy coverage that it was aware of at the time it assumed the defense. See CUSHMAN, *supra* note 127, § 2.28, at 73.

184. See *infra* notes 185-91 and accompanying text.

185. APPLEMAN, *supra* note 23, § 4686, at 169.

waiver agreement is a bilateral agreement entered into between the insurer and the insured. The agreement states that the insurer's assumption of the defense does not constitute a waiver of the insurer's right to contest coverage and does not estop the insurer from later asserting coverage defenses.¹⁸⁶ A reservation of rights letter is a unilateral communication from the insurer to the insured that is intended to have the same effect.¹⁸⁷ To be valid, both forms of reservation must be prompt¹⁸⁸ and specific.¹⁸⁹ If the insurer learns of additional grounds for denial of coverage after making the initial reservation, a supplemental reservation should be sent specifying the new defenses.¹⁹⁰

As a practical matter, when the insurer assumes the insured's defense under a reservation of rights, it (1) avoids a possible breach of contract; (2) avoids possible waiver; (3) avoids being estopped from denying coverage; and (4) maintains control over the defense of the action.¹⁹¹ In some situations the reservation presents a conflict of interest among the defense attorney, the insured, and the insurer.¹⁹² In the event of a conflict, the insurer may be required to hire independent defense counsel or reimburse the insured for counsel selected by the insured.¹⁹³

D. *Non-Duty to Defend Policies: Ducking the Duty to Defend Problem*

Although most liability insurance policies, typified by the CGL policy, contain a duty to defend provision in addition to the indemnity provision,¹⁹⁴ some do not.¹⁹⁵ These policies are

186. *Id.*

187. *Id.*

188. See *Van Wyck Assocs. v. St. Paul Fire & Marine Ins. Co.*, 115 Misc. 2d 447, 454 N.Y.S.2d 266 (Sup. Ct. 1982) (holding that insurer's notice two days after initially agreeing to defend did not estop insurer from denying coverage); *Globe Indem. Co. v. Franklin Paving Co.*, 77 A.D.2d 581, 430 N.Y.S.2d 109 (2d Dep't 1980) (holding that insurer's delay of fourteen months in denying coverage estopped it from denying coverage). See generally APPLEMAN, *supra* note 23, § 4692, at 296.

189. See CUSHMAN, *supra* note 127, § 2.28, at 73; Zeavin, *supra* note 58, at 666.

190. See CUSHMAN, *supra* note 127, § 2.28, at 73.

191. See *supra* notes 178-90 and accompanying text.

192. For a thorough discussion of the conflict of interest problem, see WINDT, *supra* note 27, §§ 4.18-4.22, at 169-83.

193. *New York State Urban Dev. Corp. v. VSL Corp.*, 563 F. Supp. 187, 190 (S.D.N.Y. 1983).

194. See *supra* notes 22-25 and accompanying text.

known as "single promise" policies, in contrast to "dual promise" policies.¹⁹⁶ In a single promise policy, the insurer's only obligation is to indemnify the insured after the insured has actually suffered a loss covered by the policy.¹⁹⁷ Most single promise indemnity policies do contain a provision, however, that obligates the insurer to indemnify the insured for costs incurred in its defense.¹⁹⁸

There are several distinct differences in an insurer's obligation concerning defense costs under a single promise policy. First, the typical provision obligating the insurer to pay for defense costs in a single promise policy contains no reference to the defense of groundless claims.¹⁹⁹ Therefore, the insurer is required to indemnify the insured only for defense costs that arise out of claims that are covered under the policy and for which the insured is found to be legally liable.²⁰⁰ Second, the single promise policy does not confer upon the insurer the right to provide counsel for the litigation or to control the litigation.²⁰¹ Thus, if the policy expressly denies the obligation to pay for defense costs as they are incurred, the insurer's obligation to indemnify the insured for defense costs does not arise until either the date of disposition of the claim, or upon the determination of the insurer's liability under the insurance policy.²⁰²

Third, under a single promise policy the insurer may not be obligated to pay for all of the defense costs where some of the claims asserted are not covered under the policy.²⁰³ In order to

195. Kennedy, *supra* note 3, at 27.

196. *Id.* A dual promise policy contains two promises: the promise to defend and the promise to indemnify. See APPLEMAN, *supra* note 23.

197. See Kennedy, *supra* note 3, at 27.

198. WINDT, *supra* note 27, § 6.18, at 328.

199. Joel M. Simon, *Non-Duty To Defend Policies: Defense Costs*, N.Y.S.B.J., Jan. 1991, at 17.

200. *Id.*

201. *Pepsico v. Continental Cas. Co.*, 640 F. Supp. 656, 666 (S.D.N.Y. 1986).

202. *Board of Educ. v. CNA Ins. Co.*, 647 F. Supp. 1495, 1507 (S.D.N.Y. 1986), *aff'd*, 839 F.2d 14 (2d Cir. 1988).

203. Simon, *supra* note 199, at 18, 20. This is in contrast to the dual promise policies, such as the standard CGL policy, where the insurer is obligated to pay all of the defense costs. See *supra* note 53 and accompanying text. According to the New York State Department of Insurance, in single promise policies, the insurer must pay all of the insured's defense costs unless an express policy provision allows for allocation. Simon, *supra* note 199, at 18 n.15.

allocate defense costs, the insurer has the burden of showing that the defense costs sought to be allocated are separate and distinct from the uncovered claims costs.²⁰⁴ Where contemporaneous payments²⁰⁵ are required and an allocation between covered and uncovered defense costs initially cannot be determined, the insurer may later seek reimbursement of those costs advanced to the insured for uncovered claims.²⁰⁶ For an insurer to be entitled to reimbursement, the policy must have a provision declaring this right.²⁰⁷ Here, again, the burden is on the insurer to prove that the amount it seeks as reimbursement is clearly separate from the amount for covered claims.²⁰⁸

From the insurer's perspective, the single promise indemnity policy appears to be a favorable alternative to the standard dual promise liability policy with regard to defense costs.²⁰⁹ If the policy provides for reimbursement of defense costs but expressly states that there is no duty to make contemporaneous payments, the insurer is only obligated to indemnify the insured for defense costs for adjudicated covered claims.²¹⁰ Although the insurer loses control over the defense and the settlement process, the direct result is that the insurer's defense costs are lower than the defense costs under the standard dual promise policy.²¹¹

III. *Fitzpatrick v. American Honda Motor Co.*

A. *Introduction*

In *Fitzpatrick v. American Honda Motor Co.*,²¹² the New York Court of Appeals abandoned the traditional four corners of the complaint rule used to determine when an insurer's duty to

204. *Pepsico*, 640 F. Supp. at 660.

205. Contemporaneous payment of insurance defense costs is required where there is not an express provision in the policy denying that obligation. *See id.* at 659-66.

206. *Id.* at 659.

207. *Id.* Other jurisdictions have also allowed an insurer to reserve the right to recover defense costs later determined to be for uncovered claims. *See, e.g., Okada v. MGIC Indem. Corp.*, 608 F. Supp. 383 (D. Haw. 1985).

208. Simon, *supra* note 199, at 20.

209. *See supra* notes 197-208 and accompanying text.

210. *See supra* notes 197-208 and accompanying text.

211. *See supra* notes 197-210 and accompanying text.

212. 78 N.Y.2d 61, 575 N.E.2d 90, 571 N.Y.S.2d 672 (1991).

defend its insured is triggered.²¹³ The four corners of the complaint rule employed an objective comparison test that only required the insurer to compare the policy to the facts alleged in the complaint in determining whether coverage might exist under the policy and consequently trigger its duty to defend.²¹⁴ The new rule of *Fitzpatrick* hinges the insurer's duty to defend on a subjective test, requiring an insurer to defend based on its actual knowledge of the claim as well as on the facts alleged in the complaint.²¹⁵ After *Fitzpatrick*, unless the complaint states facts sufficient to invoke a duty to defend under the policy, the insurer is left in a state of uncertainty — to defend or not to defend?²¹⁶

In the underlying action, Linda Fitzpatrick (the plaintiff) sought to recover damages for the wrongful death of her husband.²¹⁷ The complaint alleged that the decedent was fatally injured while operating a 1985 Honda all-terrain vehicle owned by defendant Frank Moramarco and operated on property owned by Cherrywood Property Owners Association (CPOA).²¹⁸ The complaint further alleged that Moramarco, an employee of CPOA, hired the decedent as an independent contractor to perform certain services.²¹⁹ The plaintiff sought recovery from CPOA as the property owner where the incident occurred and from Moramarco as the owner of the vehicle.²²⁰ After defendant Moramarco received the summons and complaint, he notified National Casualty Company (National)²²¹ requesting that the insurer provide him with a defense.²²²

National had issued a Manufacturer's and Contractor's Lia-

213. *Id.* at 70, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

214. *Id.* at 65, 71, 575 N.E.2d at 91-92, 96, 571 N.Y.S.2d at 673-74, 678.

215. *Id.* at 67, 575 N.E.2d at 93, 571 N.Y.S.2d at 675.

216. See Anthony J. McNulty, *The Duty To Defend Dilemma After Fitzpatrick v. American Honda Motor Co., Inc. and Moramarco*, DEFENDANT (Defense Ass'n of N.Y.), Sept. 1991, at 19.

217. *Fitzpatrick*, 78 N.Y.2d at 63, 575 N.E.2d at 90, 571 N.Y.S.2d at 672.

218. *Id.*

219. *Id.*, 575 N.E.2d at 91, 571 N.Y.S.2d at 672-73.

220. *Fitzpatrick v. American Honda Motor Co.*, 159 A.D.2d 548, 549, 552 N.Y.S.2d 413, 414 (2d Dep't 1990).

221. National is a subsidiary of Nationwide Insurance Company. Respondent's Brief (Cover), *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 575 N.E.2d 90, 571 N.Y.S.2d 672 (1991) (No. 14233/87) [hereinafter *Respondent's Brief*].

222. *Fitzpatrick*, 78 N.Y.2d at 64, 575 N.E.2d at 91, 571 N.Y.S.2d at 673.

bility Policy to Cherrywood Landscaping Incorporated (CLI),²²³ of which Moramarco was the sole stockholder and president.²²⁴ The policy afforded liability coverage to the corporation only, but named as additional insureds "any executive officer, director or stockholder . . . [thereof] while acting within the scope of his duties as such."²²⁵ National refused to provide a defense for Moramarco, "stating that the policy it had issued to CLI did not appear to cover the claim."²²⁶ Following National's refusal, Moramarco commenced a third-party action against National seeking defense costs and liability indemnification.²²⁷

B. *Procedural History*

Moramarco's third-party action sought payment of his legal fees and indemnity for any judgment that might be entered against him in the main action.²²⁸ National moved to dismiss the action pursuant to New York Civil Practice Law and Rules sections 3211(a)(1) and (7).²²⁹ In response to National's motion to dismiss, Moramarco submitted an affidavit asserting that he was acting in his corporate capacity of CLI at the time of the accident and therefore was an additional insured under the policy.²³⁰ The trial court denied National's motion to dismiss, holding that the coverage issue "must await a plenary trial."²³¹

On appeal, the Appellate Division unanimously reversed on the facts and dismissed the third-party complaint.²³² The court held that whether coverage exists is a matter of law, and that the determination is made by examining the allegations of the

223. *Fitzpatrick*, 159 A.D.2d at 549, 552 N.Y.S.2d at 414.

224. Appellant's Brief at 2, *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 575 N.E.2d 90, 571 N.Y.S.2d 672 (1991) (No. 14233/87) [hereinafter *Appellant's Brief*].

225. *Fitzpatrick*, 78 N.Y.2d at 64, 575 N.E.2d at 91, 571 N.Y.S.2d at 673.

226. *Id.*

227. *Id.*

228. *Id.*

229. N.Y. CIV. PRAC. L. & R. 3211 (McKinney 1992). A C.P.L.R. 3211(a)(1) motion to dismiss is based on the ground that a defense is founded on documentary evidence; a C.P.L.R. 3211(a)(7) motion to dismiss is based on the ground that the pleading fails to state a cause of action. *Id.*

230. *Fitzpatrick*, 78 N.Y.2d at 64, 575 N.E.2d at 91, 571 N.Y.S.2d at 673.

231. *Id.* A plenary trial is a complete trial on the merits as distinguished from a summary hearing. BLACK'S LAW DICTIONARY 1154 (6th ed. 1990).

232. *Fitzpatrick v. American Honda Motor Co.*, 159 A.D.2d 548, 552 N.Y.S.2d 413 (2d Dep't 1990).

complaint.²³³ The court made the following findings of fact: (1) the insured, CLI, was not named in the complaint; (2) the complaint named Moramarco in his individual capacity, not in his corporate capacity as required under the CLI policy in order to qualify as an additional insured; and (3) Moramarco did not assert that he acted in his corporate capacity until after National moved to dismiss.²³⁴ The court held that the documentary evidence²³⁵ submitted by National was sufficient to support a motion to dismiss and that the complaint allegations did not bring the claim within the insurance coverage of the policy held by CLI.²³⁶ The court granted National's motion to dismiss.²³⁷ The New York Court of Appeals granted leave for Moramarco to appeal from the Appellate Division.²³⁸

C. *Facts of the Case*

On appeal, Moramarco submitted a record for the court's review that contained: (1) the documentary evidence submitted by National in its motion to dismiss, including the insurance policy and the main complaint; and (2) the extrinsic evidence consisting of the third-party complaint, Moramarco's affidavit in opposition to National's motion to dismiss, and other relevant information.²³⁹

1. *The Documentary Evidence*

a. *The Insurance Policy*

The insurance policy issued to CLI was a Manufacturer's and Contractor's Liability Policy.²⁴⁰ The policy coverage section provided that:

233. *Id.* at 549, 552 N.Y.S.2d at 414.

234. *Id.* at 549-50, 552 N.Y.S.2d at 414.

235. The court was referring to the complaint and the insurance policy.

236. *Fitzpatrick*, 159 A.D.2d at 550, 552 N.Y.S.2d at 414.

237. *Id.*

238. *Fitzpatrick v. American Honda Motor Co.*, 76 N.Y.2d 702, 558 N.E.2d 41, 559 N.Y.S.2d 239 (1990).

239. Record at 1-92, *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 575 N.E.2d 90, 571 N.Y.S.2d 672 (1991) (No. 14233/87) [hereinafter *Record*].

240. *Id.* at 42. For a brief discussion of this type of policy, see *supra* notes 39-40 and accompanying text.

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

. . . .²⁴¹

In addition to providing coverage for the named insured, here CLI, the policy provided for liability coverage of any executive, director or stockholder of CLI while acting within the scope of his duties of such position.²⁴² The exclusion section of the policy stated that "[t]his insurance does not apply . . . (q) to bodily injury or property damage arising out of operations performed for the named Insured by independent contractors or acts or omissions of the named Insured in connection with his general supervision of such operations"²⁴³

b. *The Main Complaint*

The plaintiff's complaint in the underlying action alleged that her husband, John J. Fitzpatrick, died as a result of the negligence and carelessness of the defendants Frank Moramarco and Cherrywood Property Owner's Association (CPOA).²⁴⁴ The

241. *Record*, *supra* note 239, at 43 (emphasis added).

242. The "Persons Insured" section of the policy stated:

Each of the following is an Insured under this Insurance to the extent set forth below . . . (c) if the named Insured is designated in the declarations as other than an individual, partnership or joint venture, the organization so designated and any executive officer, director or stockholder thereof while acting within the scope of his duties as such

Id. at 44.

243. *Id.* This exclusion section was particularly relevant in National's decision not to defend because the plaintiff's complaint specifically stated that the decedent was an independent contractor for CLI. *See supra* text accompanying note 219.

244. *Record*, *supra* note 239, at 24. Paragraph 39 of the complaint stated "[t]hat . . . the defendants, Cherrywood and Frank Moramarco, were negligent and careless in the ownership, operation, maintenance, administration and control of the premises owned by Cherrywood, and were further negligent and careless in the ownership, maintenance, use,

complaint also alleged that Moramarco was an employee of CPOA²⁴⁵ and that the decedent was employed as an independent contractor by Moramarco and/or CPOA.²⁴⁶ In addition, the allegations in the complaint stated that at the time of the fatal incident neither Moramarco nor CPOA was engaged in any activity for pecuniary gain.²⁴⁷

The plaintiff alleged in the complaint that the decedent died as the result of injuries sustained while operating a Honda all-terrain vehicle that was owned by Moramarco²⁴⁸ and that was operated on CPOA's premises.²⁴⁹ Specifically, the complaint alleged that the defendants were negligent and careless in the supervision and control of the Honda all-terrain vehicle and in the ownership and control of the premises where the fatal accident occurred.²⁵⁰

2. *The Extrinsic Evidence*

a. *The Third-Party Complaint*

The third-party complaint instituted by Moramarco against National alleged that National had issued an insurance policy to Moramarco's employer, CLI.²⁵¹ The complaint further alleged that the plaintiff in the main action named Moramarco as a defendant "entirely on the basis of events arising out of [his] employment" with CLI.²⁵² Therefore, Moramarco alleged that under the terms of the insurance policy issued to CLI, National was "obliged to defend and indemnify" him in the action.²⁵³

supervision and control of the 1985 Honda ATC herein." *Id.* Paragraph 40 stated "[t]hat as a result of the negligence and carelessness of these defendants, John J. Fitzpatrick, Jr. died on or about October 31, 1985." *Id.*

245. *Id.* at 20. Plaintiff's allegation places Moramarco's claim within a policy exclusion of CLI's policy — because it is a Manufacturer's and Contractor's policy it does not provide coverage for liability arising from the use of independent contractors. *See supra* notes 39-40, 243 and accompanying text.

246. *Record, supra* note 239, at 21.

247. *Id.* at 22.

248. *Id.* at 21, 24.

249. *Id.* at 22.

250. *Id.* at 22, 24.

251. *Id.* at 15-16.

252. *Id.* at 16.

253. *Id.*

b. *Moramarco's Affidavit in Response to National's Motion to Dismiss*

Upon receiving the third-party complaint, National moved to dismiss the complaint.²⁵⁴ National based its motion on the fact that the main complaint did not name its insured, CLI, and that the main complaint did not allege any facts that would trigger coverage under the terms of the policy.²⁵⁵ In response, Moramarco submitted an affidavit in opposition to the motion claiming that based on the true facts, the event fell within the terms of the policy issued to CLI and therefore National was obligated to defend and indemnify him.²⁵⁶

In his affidavit, Moramarco stated that CPOA hired CLI to do grounds work on its property.²⁵⁷ Moramarco also stated that he was a stockholder, director, president, and chief executive officer of CLI.²⁵⁸ Furthermore, Moramarco stated that in contrast to the facts alleged in the main complaint, CLI was the owner of the Honda all-terrain vehicle, employed him, and employed the decedent.²⁵⁹

Moramarco stated that based on the persons insured section of the insurance policy issued to CLI, which included as an insured "any executive officer . . . while acting within the scope of his duties as such,"²⁶⁰ he was an insured.²⁶¹ He explained that if the event occurred as alleged in the complaint, he was acting in his supervisory role as president of CLI and therefore the event fell within the coverage terms of the policy.²⁶²

254. *Id.* at 12-13.

255. *Id.*

256. *Id.* at 53-56.

257. *Id.* at 55.

258. *Id.* at 53.

259. *Id.* at 55.

260. *Id.* at 54.

261. *Id.* at 55, 56.

262. *Id.* at 55. Moramarco argued that the court should not permit National to "use such a minor imprecision in pleading to escape its duties under the policy it issued" and accordingly should deny the motion to dismiss. *Id.* at 56-57. The "minor imprecision" that Moramarco referred to was the allegations in the complaint that stated that he was employed by CPOA and that he was the owner of the Honda all-terrain vehicle.

3. *Other Extrinsic Information In The Record*

The record on appeal contained Moramarco's answer to the underlying complaint. The answer made assertions that were substantially similar to those in the affidavit in response to National's motion to dismiss.²⁶³ Also included was the correspondence between Moramarco and National prior to the third-party action.²⁶⁴ The correspondence contained letters from Moramarco's attorney to National stating that "since the vehicle in question was owned for and to be used exclusively for landscaping operations we expect you to provide a defense,"²⁶⁵ and "demanding a defense for the claim arising entirely out of his employment by your insured, which is required to defend its employee."²⁶⁶ In addition, the record contained a letter from Moramarco's insurance agent stating, "it is my understanding that, because this vehicle is used in the insured's landscaping operation, he would automatically be covered under his liability policy."²⁶⁷ National's response in all instances was the same: "The suit does not name Cherrywood Landscaping [CLI] — it does name the owner by name — we do *not* insure the owner as an individual — we do insure Cherrywood Landscaping [CLI]."²⁶⁸

Also submitted for the record was an affidavit from the attorney for the plaintiff in the underlying action. The affidavit stated that because Moramarco came forward with an affidavit stating that he was the president of CLI, the motion by National "must [] fail."²⁶⁹ It further stated that "[a]ny ambiguity whatsoever as to whether Frank Moramarco was an 'executive officer, director or stockholder' " at the time of the alleged incident "must be resolved in favor of the insured and against National Casualty."²⁷⁰

263. *Id.* at 27-29.

264. *Id.* at 58-91.

265. *Id.* at 58.

266. *Id.* at 68.

267. *Id.* at 85.

268. *Id.*

269. *Id.* at 93.

270. *Id.* at 94. At the time that Linda Fitzpatrick's attorney submitted this affidavit, CLI had still not been added as a codefendant in the complaint. However, CLI had been impleaded as a third-party defendant by the other defendants in the main action. See

D. *The Court of Appeals Decision*

1. *The Majority Opinion*

In a 4-3 vote, the majority reversed and denied National's motion to dismiss.²⁷¹ The Court of Appeals held that "rather than mechanically applying only the 'four corners of the complaint' rule in these circumstances, the sounder approach is to require the insurer to provide a defense when it has actual knowledge of facts establishing a reasonable possibility of coverage."²⁷² The court stated that an insurer cannot use a third-party's pleadings "as a shield to avoid its contractual duty to defend."²⁷³

Writing for the majority, Judge Titone stated that the rationale of the four corners of the complaint rule is that the duty to defend is broader than the duty to indemnify.²⁷⁴ Accordingly, the court stated that the duty to defend is triggered whenever the pleadings allege facts which potentially bring the claim within policy coverage even if extrinsic facts exist that show the claim is without merit.²⁷⁵ Therefore, the court stated that the insurer is not permitted to look beyond the complaint to avoid the obligation to defend.²⁷⁶

The court held, however, that recognizing this rule "is a far cry from saying that the complaint allegations are the sole criteria for measuring the scope of that duty."²⁷⁷ In fact, the court stated that to adhere to a "wooden application of the 'four corners of the complaint' rule would render the duty to defend narrower than the duty to indemnify — clearly an unacceptable result."²⁷⁸ The court pronounced the new rule that even where a complaint does not allege a covered occurrence, if the insurer has "actual knowledge of facts establishing a reasonable possibil-

McNulty, *supra* note 216, at 17-19.

271. *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 575 N.E.2d 90, 571 N.Y.S.2d 672 (1991).

272. *Id.* at 67, 575 N.E.2d at 93, 571 N.Y.S.2d at 675.

273. *Id.* at 63, 575 N.E.2d at 90, 571 N.Y.S.2d at 672.

274. *Id.* at 65, 575 N.E.2d at 92, 571 N.Y.S.2d at 674.

275. *Id.* at 66, 575 N.E.2d at 92, 571 N.Y.S.2d at 674.

276. *Id.*

277. *Id.*

278. *Id.*

ity of coverage," the insurer has a duty to defend.²⁷⁹

The court summarily rejected any implied corollary duty to investigate on the part of the insured.²⁸⁰ The court justified its holding by stating that: (1) the duty to defend flows in the first instance from the insurance contract between the insurer and insured;²⁸¹ (2) the insured's right to his contracted-for defense should not depend solely on the facts alleged in a third-party complaint;²⁸² (3) modern pleading rules render the initial insufficiency of alleged facts meaningless if the actual facts would come out at the first discovery process or hearing and the pleading would be amended to conform to the facts;²⁸³ and (4) to deny the defense at the inception of the lawsuit would make the insurer-provided defense provision useless.²⁸⁴

In applying the rule to the case at hand, the court stated that the insured made facts known to the insurer that "unquestionably involved a covered event."²⁸⁵ Therefore, even though the complaint on its face did not support a reasonable possibility of coverage, the insurer had a duty to defend.²⁸⁶ The court found that Moramarco had been mistakenly sued as an employee of CPOA and as the owner of the injury-causing vehicle. Had the complaint correctly identified him, he would have been covered under the policy as an additional insured.²⁸⁷ The court stated that to deny Moramarco an insurer-provided defense would "afford the insurer [National] an undeserved windfall"²⁸⁸ and was not within Moramarco's reasonable expectation when he purchased the policy.²⁸⁹

The court concluded that an application of the four corners of the complaint rule was not required by its prior cases²⁹⁰ and

279. *Id.* at 67, 575 N.E.2d at 93, 571 N.Y.S.2d at 675.

280. *Id.* at 67 n.2, 575 N.E.2d at 93 n.2, 571 N.Y.S.2d at 675 n.2.

281. *Id.* at 68, 575 N.E.2d at 93, 571 N.Y.S.2d at 675.

282. *Id.*

283. *Id.* at 68-69, 575 N.E.2d at 94, 571 N.Y.S.2d at 676.

284. *Id.* at 70, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

285. *Id.* at 69, 575 N.E.2d at 94, 571 N.Y.S.2d at 676.

286. *Id.*

287. *Id.*

288. *Id.*

289. *Id.* at 69 n.4, 575 N.E.2d at 94 n.4, 571 N.Y.S.2d at 676 n.4.

290. *Id.* at 70, 575 N.E.2d at 95, 571 N.Y.S.2d at 677. The court here was referring to *Commercial Pipe & Supply Co. v. Allstate Ins. Co.*, 36 A.D.2d 412, 331 N.Y.S.2d 219 (4th Dep't), *aff'd*, 30 N.Y.2d 619, 282 N.E.2d 128, 331 N.Y.S.2d 42 (1972) and *Sucrest*

that to do so would "exalt [] form over substance."²⁹¹ Therefore, the court held that an insurer is required "to provide a defense where, notwithstanding the complaint allegations, underlying facts made known to the insurer create a 'reasonable possibility that the insured may be liable for some act or omission covered by the policy.'"²⁹² The court reversed the lower court's holding and reinstated the complaint against National.²⁹³

2. *The Dissent*

The three-judge dissent, written by Judge Alexander, found no justification for abandoning the well established four corners of the complaint rule.²⁹⁴ Judge Alexander stated that "[i]t is axiomatic that the obligations of a liability insurance carrier to its insured are governed by the terms of the contract of insurance between them and it is only by examining the terms and conditions of that policy that those obligations can be determined with certainty."²⁹⁵ The dissent maintained that the determination of whether there is a duty to defend should be made by comparing the terms of the policy with the allegations of the complaint²⁹⁶ and noted that this rule "serves to give certainty and definiteness to the insurer's duty to defend."²⁹⁷ Further, Judge Alexander asserted that the new rule advanced by the majority "abandons any truly objective standard" and "expresses the majority's intent to substitute an uncertain subjective standard."²⁹⁸

Readily acknowledging the principle that the duty to defend is broader than the duty to indemnify,²⁹⁹ the dissent maintained that where the "allegations, on their face, are within the compass of the risk covered by the insurance policy, the insurer is

Corp. v. Fisher Governor Co., 83 Misc. 2d 394, 371 N.Y.S.2d 927 (Sup. Ct. 1975). See *supra* notes 77-97 and accompanying text.

291. *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 70, 575 N.E.2d 90, 95, 571 N.Y.S.2d 672, 677 (1991).

292. *Id.*

293. *Id.*

294. *Id.*, 575 N.E.2d at 95, 571 N.Y.S.2d at 677 (Alexander, J., dissenting).

295. *Id.* at 70-71, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

296. *Id.* at 71, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

297. *Id.* at 71 n.1, 575 N.E.2d at 96 n.1, 571 N.Y.S.2d at 678 n.1.

298. *Id.*

299. *Id.* at 71, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

obligated [to defend]."³⁰⁰ Thus, to Judge Alexander, it logically followed that if the allegations are not within the coverage of the policy, the insurer does not have a duty to defend.³⁰¹ The dissent further noted that this had been the long established rule, unbroken until now.³⁰²

In applying the rule to the case at hand, the dissent found that National had no duty to defend because: (1) CLI was not a named defendant; (2) Moramarco as an individual was not a named insured; (3) the complaint did not allege that Moramarco was acting as an officer of CLI; and (4) the complaint in fact alleged that Moramarco was an agent of CPOA and that CPOA was not an insured under the policy.³⁰³ By "[d]eviating from . . . settled rules" and requiring an insurer to provide a defense based on its knowledge of facts outside the complaint relating to the claim, Judge Alexander noted that the majority failed to acknowledge a new implied duty to investigate — "a requirement that th[e] Court ha[d] never before imposed."³⁰⁴

Furthermore, the dissent noted that the two New York cases relied upon by the majority to support the "expanded" rule did not in fact stand for that proposition.³⁰⁵ Specifically, it stated that in *Commercial Pipe & Supply Corp. v. Allstate*³⁰⁶ the court merely relied on the potentiality interpretation of the four corners of the complaint rule, that the allegations of the complaint potentially brought the case within the coverage of the policy.³⁰⁷ In *Sucrest v. Fisher Governor Co.*,³⁰⁸ the court relied upon the allegations of the underlying complaint in conjunction with allegations in a supplemental complaint, to determine whether there was a duty to defend.³⁰⁹ Therefore, the *Fitzpat-*

300. *Id.*, 575 N.E.2d at 96, 571 N.Y.S.2d at 678.

301. *Id.* at 72, 575 N.E.2d at 96, 571 N.Y.S.2d at 678.

302. *Id.* at 71, 575 N.E.2d at 95, 571 N.Y.S.2d at 677.

303. *Id.* at 72-73, 575 N.E.2d at 96, 571 N.Y.S.2d at 678-79. In fact, the main complaint further alleged that Moramarco was not engaged in any activity for pecuniary gain, thereby directly contradicting Moramarco's claim that he was acting in his corporate capacity. See *supra* note 247 and accompanying text.

304. *Fitzpatrick v. American Honda Motor Co.*, 78 N.Y.2d 61, 73, 575 N.E.2d 90, 97, 571 N.Y.S.2d 672, 679. (1991).

305. *Id.* at 73 n.2, 575 N.E.2d at 97 n.2, 571 N.Y.S.2d at 679 n.2.

306. See *supra* notes 77-86 and accompanying text.

307. *Fitzpatrick*, 78 N.Y.2d at 73 n.2, 575 N.E.2d at 97 n.2, 571 N.Y.S.2d at 679 n.2.

308. See *supra* notes 87-97 and accompanying text.

309. *Fitzpatrick*, 78 N.Y.2d at 73 n.2, 575 N.E.2d at 97 n.2, 571 N.Y.S.2d at 679 n.2.

rick dissent maintained that the majority had based its new rule on erroneous interpretations of those cases.³¹⁰

The dissent concluded that: (1) the new rule supplants certainty with uncertainty; (2) the new rule will increase collateral proceedings to determine whether the duty to defend exists; and (3) those proceedings will be more complicated because the courts will no longer have an objective test — they will have to look beyond the complaint to discover the actual facts.³¹¹

IV. Analysis

A. Fitzpatrick - A Just Rule

The new rule established by the *Fitzpatrick* majority provides for just and equitable results, and enforces the contracted-for right of an insurer-provided defense.³¹² Under the new rule, when an insurer determines whether it has a duty to defend its insured, it must consider not only those facts alleged in the complaint but also those facts of which it has knowledge.³¹³ Therefore, an insurer is prohibited from using third-party pleadings “as a shield to avoid its contractual duty to defend”³¹⁴ and is required to provide a defense even when the complaint fails to allege facts that invoke coverage under the policy if the insurer has “actual knowledge of facts establishing a reasonable possibility of coverage.”³¹⁵

The practical result of the *Fitzpatrick* rule is that an insured will now be able to enforce the defense provision of the insurance policy in those situations when the actual facts are different from the facts alleged in the complaint. The insured's right to an insurer-provided defense will no longer be held hostage to the facts that a complete stranger chooses to include in his complaint. This result is equitable and within sound principles of contract law; a person who enters into a contract (the insurance policy) and provides consideration (the premium) should be able to enforce the provisions of the contract (indem-

310. *Id.*

311. *Id.* at 73, 575 N.E.2d at 97, 571 N.Y.S.2d at 679.

312. See *supra* notes 285-91 and accompanying text.

313. See *supra* note 272 and accompanying text.

314. See *supra* note 273.

315. See *supra* note 272.

nification and defense).

B. *An Adopted Rule - No New York Basis*

Contrary to the majority's position that consideration of facts extrinsic to the complaint had a basis in New York case law, a close examination of the cited case law reveals that no such basis existed. The majority cited two New York cases, *Commercial Pipe*³¹⁶ and *Sucrest*,³¹⁷ as examples of cases that have held that an insurer must consider extrinsic facts in its duty to defend determination.³¹⁸ Neither case, however, stands for that proposition.

In *Commercial Pipe*, the court held that the insurer had a duty to defend its insured based on the facts alleged in the complaint.³¹⁹ The court stated that the facts alleged in the complaint plus facts reasonably inferred from the complaint language were sufficient to bring the claim within the potential coverage of the policy.³²⁰ In *Sucrest*, the court also found that the insurer had a duty to defend and based its decision solely on the complaint allegations.³²¹ The court held that the insurer was required to consider the allegations in a third-party complaint served on its insured in addition to the allegations in the main complaint.³²² The court in *Sucrest*, therefore, only obligated the insurer to look at complaint allegations — not extrinsic facts.³²³ Accordingly, prior to *Fitzpatrick*, New York case law did not require an insurer to look beyond the potentiality of complaint allegations when making its duty to defend determination.

316. 36 A.D.2d 412, 321 N.Y.S.2d 219 (4th Dep't 1971).

317. 83 Misc. 2d 394, 371 N.Y.S.2d 927 (Sup. Ct. 1975).

318. See *supra* note 290 and accompanying text.

319. See *supra* note 85 and accompanying text.

320. See *supra* notes 85-86 and accompanying text.

321. See *supra* note 96 and accompanying text.

322. See *supra* note 95 and accompanying text.

323. See *supra* notes 87-97 and accompanying text.

C. *Implications Of Fitzpatrick*

1. *No New Duty To Investigate*

The *Fitzpatrick* rule neither expressly calls for nor implies a duty to investigate on the part of the insurer.³²⁴ The majority adopted the rule from other jurisdictions where no duty to investigate has been imposed.³²⁵ The *Fitzpatrick* rule, reflecting the rule existing in those jurisdictions, only requires an insurer to consider extrinsic facts of which it has actual knowledge.³²⁶ The actual knowledge of the insurer is limited to knowledge of the facts in the complaint and the facts made known to the insurer.³²⁷ Therefore, a duty to attempt to discover other facts through investigation is not imposed on the insurer.

This distinction is readily apparent by examining the rule that exists in other jurisdictions that do impose an affirmative duty to investigate on the insurer.³²⁸ In those jurisdictions, an insurer is required to consider not only the facts it knows of but also the facts that are reasonably ascertainable.³²⁹ In other words, the insurer is obligated to consider extrinsic facts it knows of or should know of when it makes the duty to defend determination.³³⁰ Thus, under this form of the rule, the insurer has an affirmative duty to investigate to discover any extrinsic facts that it should be aware of as a result of a reasonable investigation.³³¹

The dissent's concern, therefore, over a new implied duty to investigate is ill-founded.³³² The *Fitzpatrick* rule restricts the extrinsic facts that an insurer is required to consider to only those facts brought to the attention of the insurer.³³³ Consequently, in respect to investigation, the insurer does not have any new duty under *Fitzpatrick*.

324. See *supra* note 280 and accompanying text.

325. See *supra* note 100.

326. See *supra* note 279 and accompanying text.

327. See *supra* note 292 and accompanying text.

328. See *supra* note 101.

329. See *supra* note 106 and accompanying text.

330. See *supra* note 108 and accompanying text.

331. See *supra* notes 106-11 and accompanying text.

332. See *supra* note 304 and accompanying text.

333. See *supra* note 292 and accompanying text.

2. *A New Subjective Test*

The majority, in abandoning the four corners of the complaint rule as the touchstone for determining when the insurer's duty to defend is triggered, also abandoned the longstanding objective comparison test.³³⁴ Under the objective comparison test, the insurer simply compared the allegations of the complaint with the terms of the insurance policy.³³⁵ If the insurer determined that based on its review of the two documents that no reasonable possibility of coverage existed, the inquiry ended and the insurer was justified in denying an insurer-provided defense.³³⁶ If the insured disagreed with the insurer's interpretation, it could bring a declaratory judgment action against the insurer.³³⁷ In the declaratory judgment action, the court was only required to compare the two documents in making its determination, as a matter of law, whether the insurer had a duty to defend.³³⁸ This test was a practical, efficient tool to determine whether the duty to defend existed.³³⁹

In contrast, the *Fitzpatrick* rule employs a subjective test.³⁴⁰ The subjective nature of the test arises as the result of the addition of the insurer's knowledge in the duty to defend determination. The insurer must now consider those facts it has actual knowledge of concerning the claim in addition to the allegations of the complaint asserted against its insured.³⁴¹ Therefore, an insurer is obligated to consider all oral and written allegations concerning the claims that are brought to its attention.³⁴² Furthermore, in a declaratory judgment action brought to determine the insurer's duty to defend, the court will be obligated to look beyond the allegations in the complaint and determine what the insurer "actually knew" of the claim.³⁴³ As posited by the dissent, *Fitzpatrick* supplants the certainty of

334. See *supra* note 298 and accompanying text.

335. See *supra* notes 275-76, 296 and accompanying text.

336. See *supra* notes 119-26 and accompanying text.

337. See *supra* notes 162-70 and accompanying text.

338. See *supra* note 133 and accompanying text.

339. See *supra* notes 131-32 and accompanying text.

340. See *supra* note 298 and accompanying text.

341. See *supra* note 272 and accompanying text.

342. See *supra* note 292 and accompanying text.

343. See *supra* note 311 and accompanying text.

the objective comparison test with the uncertainty of a subjective test.³⁴⁴

D. Fitzpatrick: *The Missing Requirement*

1. *One Step Forward, A Half Step Back*

The *Fitzpatrick* rule is a positive step that permits an insured to enforce the contracted-for right of an insurer-provided defense. The insured now has a voice in the duty to defend determination that must be heard. The adoption of the new rule, however, carries with it a new subjective test.³⁴⁵

In contrast to the objective comparison test, the subjective test is not a practical, efficient tool to determine whether the duty to defend has been triggered. The insurer cannot simply compare the documents before it and make its determination. Under *Fitzpatrick*, the insurer must now consider any other information of which it has actual knowledge that concerns the claim.³⁴⁶ This information can be from any source and may have been transferred to the insurer in written or oral form.³⁴⁷

Therefore, an insured can trigger the insurer's duty to defend by oral assertions that place the claim within policy coverage. A concern of insurers is that under the new rule, an insured can force an insurer-provided defense with mere self-serving assertions that are in direct conflict with the complaint allegations.³⁴⁸ In this scenario, the insurer's duty to defend is held hostage to the insured's assertions - to refuse would potentially expose the insurer to breach of contract with its attendant liability.³⁴⁹

In addition, a declaratory judgment action brought by either the insurer or the insured will be a more complicated proceeding.³⁵⁰ The court, in making its determination as a matter of law whether the duty to defend has been triggered, will be obli-

344. See *supra* note 311 and accompanying text.

345. See *supra* notes 334-44 and accompanying text.

346. See *supra* note 272 and accompanying text.

347. See *supra* notes 285-86 and accompanying text. The court in *Fitzpatrick* held the insurer to have actual knowledge of facts extrinsic to the complaint based on the insured's oral and written assertions.

348. See McNulty, *supra* note 216, at 18, 20.

349. See *supra* notes 141-60 and accompanying text.

350. See *supra* note 311 and accompanying text.

gated to look beyond the complaint and make a factual inquiry into what facts the insurer actually knew. Accordingly, the declaratory judgment action will no longer be the simple document review procedure that existed under the four corners of the complaint rule. Neither the parties to the action nor the court is well served by the employment of an inefficient tool to determine the insurer's duty to defend.

Furthermore, because insurers must now look beyond the documents to all sources from which actual knowledge may be gained, they may become increasingly uncertain about coverage determinations.³⁵¹ Insurers, knowing that the decision to deny coverage is "at [their] own peril"³⁵² and that a wrong decision will result in breach of contract damages and loss of control of the suit,³⁵³ are likely to take preventative measures. Insurers will probably make increased use of declaratory judgment actions and reservation of rights agreements or notices.³⁵⁴ Moreover, should insurers view the expansion of the duty to defend, from an already expansive rule, as a sign of an approaching absolute duty to defend, they may begin to make greater use of non-duty to defend policies.³⁵⁵ In sum, the result may be that the insurer-provided defense may become narrower rather than more expansive.

2. *A Solution*

The simple, obvious solution to the problems created by the subjective test is to return to an objective test. The reversion to an objective test can be accomplished by only requiring the insurer to consider information extrinsic to the complaint of which it has actual knowledge by sworn documents.³⁵⁶ The result would be to restore the certainty that existed under the pre-*Fitzpatrick* rule, and to regain a practical, efficient tool to deter-

351. See McNulty, *supra* note 216, at 22.

352. See *supra* note 141.

353. See *supra* notes 141-60 and accompanying text.

354. See *supra* notes 162-93 and accompanying text.

355. See *supra* notes 194-211 and accompanying text.

356. This requirement would be similar to the type of documentation required under a motion for summary judgment. See N.Y. CIV. PRAC. L. & R. 3212(b), cmt. c:3212:15 (McKinney 1991).

mine the insurer's duty to defend.³⁵⁷

The addition of the document requirement brings the form of the test back to the objective test of the four corners of the complaint rule. The insurer would simply be obligated to review the documents before it: the complaint, the policy and the extrinsic fact document(s), when making its duty to defend determination. Because the insured is required to provide the insurer with the extrinsic information, now in documentary form, the insurer has no duty to investigate.³⁵⁸ This requirement allows the insurer greater certainty regarding what information it will be deemed to have actual knowledge of. The insurer will only need to look at the documents before it.

Consequently, the declaratory judgment action brought to determine or review the insurer's duty to defend will also be simplified. As under the former rule, the court will only be obligated to review the documents before it — the same documents that the insurer reviewed — when making its determination as a matter of law whether the insurer's duty to defend was triggered. Therefore, the extrinsic fact document requirement results in an objective test that is practical and efficient.

Moreover, the extrinsic fact documentation requirement addresses the insurer's concern over the insured's orally asserting mere self-serving facts to trigger the insurer-provided defense. If the insured willfully conceals or materially misrepresents facts concerning the claim, the insurer has documentary proof to void the policy under the cooperation clause of the policy.³⁵⁹ Accordingly, the insured will be discouraged from making false factual assertions merely to invoke the insurer-provided defense and the defense duty will not be held hostage by the insured.

Therefore, under *Fitzpatrick*, with the added requirement of extrinsic fact documentation, the procedure for the duty to defend determination would start with the insurer's review of the complaint and the policy; if this examination reveals a reasonable possibility of coverage, the insurer must defend. If it does not, the insurer must notify the insured of the initial refusal to defend, and then inform the insured that if the actual

357. See *supra* notes 131-34 and accompanying text.

358. See *supra* notes 324-33 and accompanying text.

359. See *supra* note 115 and accompanying text.

facts differ from the facts alleged in the complaint, the insured may provide the insurer with a sworn document setting forth the actual facts. If this document is provided to the insurer, the insurer must then review the extrinsic fact document in conjunction with the complaint and the policy to determine if the duty to defend has been triggered. This procedure, which incorporates the extrinsic fact documentation, provides for fairness, certainty and efficiency.

V. Conclusion

In New York, the four corners of the complaint rule no longer serves as the established rule for determining the existence of the insurer's duty to defend its insured. Under *Fitzpatrick*, the insurer's duty to defend is triggered not only when the facts in the complaint against the insured raise a reasonable possibility of coverage under the policy, but also when the insurer has actual knowledge of facts extrinsic to the complaint that establish a reasonable possibility of coverage. Now, the insured's right to an insurer-provided defense cannot be held hostage to the facts that the plaintiff chooses to include in its complaint.

The *Fitzpatrick* rule, however, employs a subjective test that serves neither the litigants nor the court well. Adoption of the proposed extrinsic fact documentation requirement will return practicality, certainty, and efficiency to the duty to defend determination while maintaining the just and equitable results of *Fitzpatrick*.

*Clifford A. Platt**

* The author dedicates this Note to his wife, Katherine A. Platt. In addition, he wishes to thank all those who provided their help and support.