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Insurance Coverage Decisions: Issued Today - Impact Tomorrow



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The Duty To Defend Is Coming To Town: 10th Circuit Uses “Extrinsic Evidence” To Sleigh Insurer

Some people get into bar fights. Others, such as those that are 5’4” and wear glasses and a bowtie, are also involved in bar fights - they analyze the insurance issues that arise from them. We all have our roles to play.

I love a good bar fight coverage case. Their facts are often-times ripe for producing interesting decisions concerning a variety of coverage issues. They are also a window into the world of those whose lives are more exciting than my own. My idea of criminal conduct is to sample a grape at the supermarket before committing to purchase the entire bag. Bar fight coverage cases demonstrate how much more potential is out there.

The Tenth Circuit Court of Appeals recently tackled an insurer’s duty to defend in a bar fight case. The crux of the case was the impact of extrinsic evidence on the insurer’s duty. The standard for determining an insurer’s duty to defend is, by far, the most important coverage issue there is. It is the granddaddy of them all. Every other important issue is just battling for second place – and a distant one at that.

When I say the *standard for determining an insurer’s duty to defend*, I do not mean that an insurer’s duty to defend is broader than its duty to indemnify. Nor that the duty to defend generally exists if there is any potential for coverage. These are rules that, in general, do not deviate much from state to state. The real duty to defend standard – the one that matters and deviates between states -- is whether an insurer’s duty is determined based solely on the four corners of the complaint or if extrinsic evidence may be considered.

The duty to defend standard is relevant in every liability claim that involves a civil action. No matter the facts, nor any other coverage issues that may be in play, the duty to defend standard is the gatekeeper of the policy. If a duty to defend is owed, the insurer is now committed to incurring expenses. And even if no duty to indemnify should ultimately be owed, or even if the insured's liability is defensible, the insurer's obligation for (potentially significant) defense costs may cause it to settle the claim and make an indemnity payment nonetheless.

By my count, about 35-ish states allow for the consideration of extrinsic evidence, in one form or another, to determine an insurer's duty to defend. While many states have adopted an "extrinsic evidence" duty to defend standard, such pronouncements are sometimes stated as general rules and there is less available guidance about just how they operate. See *Talen v. Employers Mut. Cas. Co.*, 703 N.W.2d 395, 406 (Iowa 2005) ("The scope of inquiry [for the duty to defend] . . . [includes] the pleadings of the injured party and any other admissible and relevant facts in the record."); *Am. Bumper & Mfg. Co. v. Hartford Fire Ins. Co.*, 550 N.W.2d 475, 481 (Mich. 1996) ("The insurer has the duty to look behind the third party's allegations to analyze whether coverage is possible."); *Garvis v. Employers Mut. Cas. Co.*, 497 N.W.2d 254, 258 (Minn. 1993) (stating that the determination of the duty to defend includes consideration of facts of which the insurer is "aware"); *Farmland Mut. Ins. Co. v. Scruggs*, 886 So. 2d 714, 719 n.2 (Miss. 2004) (holding that, in determining whether an insurer has a duty to defend, an insurer may consider those "true facts [that] are inconsistent with the complaint," the insured brought to the insurer's attention); *Peterson v. Ohio Cas. Group*, 724 N.W.2d 765, 773–74 (Neb. 2006) (finding that a duty to defend exists where the "actual facts" reveal such a duty exists); *Am. Gen. Fire & Cas. Co. v. Progressive Cas. Co.*, 799 P.2d 1113, 1116 (N.M. 1990) ("The duty of an insurer to defend arises from the allegations on the face of the complaint or from the known but unpleaded factual basis of the claim."); *State Farm Fire & Cas. Co. v. Harbert*, 741 N.W.2d 228, 234 (S.D. 2007) ("[T]he issue of whether an insurer has a duty to defend is determined by . . . 'other evidence of record.'").

In *Mount Vernon Fire Ins. Co. v. Okmulgee Inn Venture, LLC*, the Tenth Circuit Court of Appeals recently demonstrated how an "extrinsic evidence" duty to defend standard can create a duty that unquestionably did not exist based on a "four corners" standard. Not to mention that the court did not exactly search high and low to locate the extrinsic evidence that it used to create the duty to defend.

In *Okmulgee Inn Venture*, the court addressed coverage under the following scenario:

Okmulgee Inn Venture leased space to a nightclub-bar and was a named insured on a liquor liability insurance policy. Okmulgee was insured against injuries caused by "the selling, serving or furnishing of any alcoholic beverage." *Okmulgee Inn Venture* at 2.

"In 2006, three bar patrons sustained gunshot wounds during a fight at the nightclub and sued Okmulgee, alleging, among other things, that Okmulgee failed to ensure the safety of the bar's patrons, properly train the bar's staff, or investigate the bar's operator. The only specific allegations pertaining to alcohol were that two of the three victims were under-age but were admitted to the bar and served alcohol. Mt. Vernon refused to defend

Okmulgee in these suits. Mt. Vernon asserted there was no coverage under the policy, and thus no duty to defend or indemnify, because the allegations did not indicate the injuries were caused by the selling, serving, or furnishing of alcoholic beverages. Mt. Vernon then initiated this declaratory judgment action to determine its obligations.” *Id.* at 3.

In other words, Mt. Vernon refused to defend Okmulgee because there was no allegation that the shooter was drunk or that the shooter was served alcohol. Rather, it was only alleged that the victims were served alcohol. Thus, Mt. Vernon asserted that there were no indications that alcohol caused the injuries. *Id.* at 4. The District Court agreed that no duty to defend was owed because the “precise facts alleged against the insured did not demonstrate there was coverage under the policy.” *Id.* at 2. The Tenth Circuit reversed: “We agree the facts fail to conclusively demonstrate coverage, but we think there is still a potential for coverage as permitted by Oklahoma law.” *Id.*

At the heart of the Tenth Circuit’s decision was Oklahoma’s duty to defend standard: “[T]he insurer’s duty to defend its insured arises whenever the allegations in a complaint state a cause of action that gives rise to the *possibility of a recovery* under the policy; there *need not be a probability of recovery*.” *Id.* at 5 (citations and internal quotes omitted; emphasis in original). However, this “analysis is not restricted to the four-corners of the complaint; rather, an insurer’s defense duty is determined on the basis of information gleaned from the petition (and other pleadings), from the insured and from other sources available to the insurer at the time the defense is demanded.” *Id.* (citations and internal quotes omitted). Moreover, “[t]he insurer has a duty to look behind the third party’s allegations to analyze whether coverage is possible.” *Id.* at 6 (citations and internal quotes omitted).

Applying this standard, the Tenth Circuit concluded that a defense was owed:

The parties dispute whether the facts demonstrate that alcohol caused the injuries, but the issue is whether the facts establish a *potential* for coverage, that is, whether the circumstances alleged give rise to the *possibility* that the injuries were suffered by reason of the selling, serving, or furnishing of alcoholic beverages. And on this score, we have little difficulty concluding that they do. The victims entered the bar and were served alcohol; a bar-fight ensued and witnesses recalled beer bottles shattering; then gunshots were fired by a shooter who had been previously arrested at the same bar for being drunk in public. These known and undisputed facts establish the *possibility* that alcohol contributed to the injuries. We do not mean to suggest, of course, that the potential for coverage exists because “later-revealed facts” may show coverage[.] . . . But the known and undisputed facts in this case, standing alone, establish a credible possibility that the injuries sustained were caused by the selling, serving or furnishing of alcoholic beverages.

Id. at 5-6 (emphasis in original).

While there is nothing unusual about a court looking to extrinsic evidence to determine a duty to defend, *Okmulgee Inn Venture* seemed to take it a step further – considering extrinsic evidence that might exist. The court seemed to be saying: “Come on, look at

these facts, *how could alcohol not have played a part in this.*” The court didn’t explicitly say that, but that was its clear message nonetheless.

The *Okmulgee Inn Venture* court was quick to add that, by its decision, Mt. Vernon’s duty to indemnify was not yet ripe. But having found a duty to defend – that admittedly did not exist based on the four corners of the complaint – the underlying plaintiff is now in a position to use the insurer’s exposure for defense costs as leverage to secure a settlement than may otherwise be subject to coverage or liability defenses.

A copy of the 10th Circuit’s December 8th decision in *Mount Vernon Fire Ins. Co. v. Okmulgee Inn Venture, LLC* can be accessed here:

<http://www.ca10.uscourts.gov/opinions/11/11-7036.pdf>

If you have any questions, please let me know.

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