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California Court of Appeal Decides Key Insurance Coverage Issues

Insurance Coverage Alert

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The California Court of Appeal recently considered three major coverage-related issues: (1) the facts that can be considered to determine the duty to defend; (2) the importance of securing a clear special verdict in an underlying matter to resolve fact-based coverage issues; and (3) the burden of proof that a nonparticipating joint insurer will face in a later contribution lawsuit by the participating carrier. *Arrowood Indemnity Co. v. Travelers Indemnity Co. of Connecticut*, 2010 WL 3896619 (Cal. App. 2nd Dist. Oct. 6, 2010).

Arrowood succeeded Travelers as a contractor's general liability insurer. The contractor was sued for construction defects that allegedly arose from work done during Arrowood's policy period. Arrowood defended under a reservation of rights. Later discovery showed that the defects spanned both insurers' policies. Arrowood tendered to Travelers, which agreed to jointly defend the insured under a reservation of rights. After a jury trial, a verdict was returned against the insured. Travelers refused to contribute to the judgment, asserting that the jury found liability only for work performed during Arrowood's policy period.

Arrowood sued Travelers for one-half of all defense and indemnity payments. Travelers counterclaimed for reimbursement of its contribution to the insured's defense costs.

The Court of Appeal first found that Travelers owed a defense even though the underlying complaint did not allege defects during Travelers' policy period. Analyzing long-standing California law, the court held that facts obtained during discovery may trigger the duty to defend, and coverage is not solely determined by the facts alleged in the complaint: "[a]s we have said, 'that the precise causes of action pled by the third party complaint may fall outside policy coverage does not excuse the duty to defend where, under the facts alleged, reasonably inferable, or otherwise known, the complaint could fairly be amended to state a covered liability.' (*Scottsdale Ins. Co. v. MV Transportation* 36 Cal. 4th 643, 654 [2005])."

The court next rejected Travelers' contention that the jury's special verdict found liability only for the work

performed during the Arrowood policy period. The court found that while some jury questions addressed acts by date, others were not similarly date-specific, leaving it unclear whether the jury assessed liability for work done by the insured during the Travelers policy period, as well as the later work done during the Arrowood policy period.

Finally, the court addressed the burden of proof on a carrier that shares in the defense but refuses to share in the indemnity. In *Safeco Ins. Co. of America v. Superior Court* 140 Cal. App. 4th 874, 44 Cal. Rptr. 3d 841 (2006), the court held that where the nonparticipating insurer has a duty to defend and the underlying matter resolves by settlement, the nonparticipating insurer has the burden to prove that it had no indemnity obligation. The participating insurer does not have to show that coverage under the nonparticipating carrier's policy actually exists, but only that coverage potentially exists. At that point, the burden shifts to the nonparticipating insurer to prove that it has no coverage. The rule is based on equitable and public policy considerations, since a contrary rule would encourage carriers to refuse any contribution towards indemnity, where there was any possibility of noncoverage. *Arrowood* essentially extends the *Safeco* burden-shifting mechanism to underlying matters that resolve by jury verdict.

Practice Note
Arrowood is most significant for establishing the difficult burden on a carrier that has a duty to defend but refuses to contribute towards a judgment, and the importance of asking clear special questions to carry that burden. A growing number of policies are requiring the insured to direct counsel to secure a special verdict that will assist the insurer in resolving disputed coverage issues, if requested by the insurer. But *Arrowood* shows that the right to a special verdict does not guarantee a resolution of the coverage issues during the underlying case if the special questions are unclear.

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