THOMSON REUTERS
PRACTICAL LAW™

Insurer's Duties to Defend and Indemnify: California

by Anthony J. Ellrod, Manning & Kass, Ellrod, Ramirez, Trester, with Practical Law Commercial Transactions

Status: **Law stated as of 13 Nov 2020** | Jurisdiction: **California, United States**

This document is published by Practical Law and can be found at: **us.practicallaw.tr.com/w-027-2633**
Request a free trial and demonstration at: **us.practicallaw.tr.com/about/freetrial**

A Q&A guide to an insurer's duties to defend and indemnify claims and losses in California under commercial general liability (CGL) policies. This Q&A addresses state laws, court cases, and customs that impact the duties to defend and indemnify, when the duties are triggered and what they encompass, the scope of the duties, notice requirements, policy interpretation, defense and attorneys' fees, and duration.

General

1. How does an insurer's duty to defend differ from the duty to indemnify in your jurisdiction? Specifically, please discuss:

- What the duties to defend and indemnify generally encompass.
- Whether the duty to defend is broader than the duty to indemnify.
- What the basis is for the duties to defend and indemnify. Is it contract law, common law, or statute?
- When each duty is triggered and when it arises.
- Whether the insured must tender the defense to the insurer and whether the insurer has the right to control the defense.

Under California law, an insurer's duty to defend is separate from its duty to indemnify (*Aetna Cas. & Surety Co. v. Certain Underwriters*, 56 Cal. App. 3d 791, 804 (1976)).

What the Duties Encompass

In California, the duty of an insurer to defend and indemnify its insured generally requires the insurer to both:

- Retain counsel and pay all fees and costs incurred in the defense of the action against an insured for a potentially covered claim.
- Pay any judgment against the insured on a covered claim up to the policy limits.

(See *Griffin Dewatering Corp. v. N. Ins. Co. of New York*, 176 Cal. App. 4th 172, 196 (2009) (discussing the benefits provided to an insured under a CGL policy).)

California law permits insurance companies to limit coverage as they see fit, so long as the policies are not contrary to public policy or the law (*Lumberman's Mut. Cas. Co. v. Wyman*, 64 Cal. App. 3d 252, 259 (1976)).

Which Duty Is Broader

Under California law, an insurer's duty to defend is much broader than its duty to indemnify. If any claims in a third-party complaint are even potentially covered by the policy, the insurer must provide a defense to all the claims asserted in the complaint (*Hartford Cas. Ins. Co. v. J.R. Mktg., L.L.C.*, 61 Cal. 4th 988, 997 (2015)). This broad obligation to defend is required because the provision of an immediate, complete defense to all claims in an action asserting both covered and non-covered claims is "prophylactically" necessary, even if outside of the policy's strict terms, to protect the insured's litigation rights with respect to the potentially covered claims (*Buss v. Superior Court*, 16 Cal. 4th 35, 48-49 (1997)). For information on mixed claims, see Question 8.

Because the duty to defend is broader than the duty to indemnify, if there is no duty to defend there cannot be a duty to indemnify.

Basis for the Duties

In California, the duty to defend and the duty to indemnify are generally both contractual in nature, with the insurance policy setting forth the obligations of the parties (see

Stein v. Int'l Ins. Co., 217 Cal. App. 3d 609, 613 (1990) (stating "An insurance policy is, fundamentally, a contract between the insurer and the insured")). Cal. Civil Code § 2778, which governs the interpretation of indemnity contracts, also applies to insurance contracts, however many of the provisions of § 2778 can be altered by the contract.

When the Duties Are Triggered and When They Arise

Duty to Defend

When the duty to defend is triggered depends upon the language of the policy. In California, to determine if the duty to defend is triggered, insurers must:

- Compare the relevant policy provisions to the allegations in the complaint.
- Consider all facts that it knew extrinsic to the complaint at the time the action was commenced.

If there is any potential or possibility of coverage under the policy, the insurer has a duty to defend the insured. (See *Montrose Chem. Corp. v. Superior Court*, 6 Cal. 4th 287, 299 (1993); see also Question 3 and Question 4.)

The duty to defend is typically triggered when a suit is filed. California courts differentiate between threats to take legal action (which do not give rise to an insurer's duty to defend) and lawsuits (which do trigger the duty to defend) (*Ameron Int'l Corp. v. Ins. Co. of State of Pennsylvania*, 50 Cal. 4th 1370, 1382-86 (2010)).

The duty to defend arises upon tender of the defense by the insured (*Montrose Chem. Corp.*, 6 Cal. 4th at 295).

Duty to Indemnify

In California, the duty to indemnify arises as soon as, and only after, the insured's liability has been established and there is an obligation to pay money damages. The duty runs to any claims that are covered by the applicable policy. (*Buss*, 16 Cal. 4th at 45-46.)

Tendering and Control of the Defense

An insurer has no duty to defend until the matter has been tendered to it by the insured (*Montrose Chem. Corp.*, 6 Cal. 4th at 295). Further, pre-tender defense fees and costs incurred by an insured are not reimbursed (*Jamestown Builders v. Gen. Star Indem. Co.*, 77 Cal. App. 4th 341, 350 (1999)).

Except in extremely limited circumstances, California courts have long held that no-voluntary-payment provisions in insurance policies are enforceable and prevent the recovery of pre-tender fees and costs (*Insua v. Scottsdale Ins. Co.*, 104 Cal. App. 4th 737, 743 (2002); see also *Nat'l Bank of California v. Progressive Cas. Ins. Co.*, 938 F. Supp. 2d 919 (C.D. Cal. 2013)). This is true even if the insurer suffered no prejudice by a delay in tender (*Jamestown Builders*, 77 Cal. App. 4th at 346, 350). Limited exceptions exist, and no-voluntary-payment provisions will be enforced "in the absence of economic necessity, insurer breach, or other extraordinary circumstances" (*Jamestown Builders*, 77 Cal. App. 4th at 346 (citing *Gribaldo, Jacobs, Jones & Assocs. v. Agrippina Versicherunges A.G.*, 3 Cal. 3d 434, 449 (1970))). For more information on no-voluntary-payment provisions, see Question 18.

The insurer typically has the right to control the defense of the case (*James 3 Corp. v. Truck Ins. Exch.*, 91 Cal. App. 4th 1093, 1105-06 (2001)). However, this right is not absolute. For instance:

- Where a conflict of interest exists between an insurer and its insured arising out of possible non-coverage under the insurer's policy that could be impacted by counsel's actions, the insurer is obligated to offer independent counsel to the insured. These independent counsel are paid for by the insurer. (Cal. Civ. Code § 2860; see also *San Diego Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal. App. 3d 358 (1984) (superseded by statute) and Question 13.)
- Where there has been a failure on the part of the insurance carrier to timely accept a tender and provide a defense, that right to control the defense can be forfeited (*Hartford Cas. Ins. Co. v. J.R. Mktg.*, 216 Cal. App. 4th 1444 (2013) (affirmed in part, reversed in part, by *Hartford Cas. Ins. Co.*, 61 Cal. 4th 988).

Duty to Defend: Notice

2. Does the duty to defend require notice of claim or loss by an insured in your jurisdiction? Specifically, please discuss:

- Who may provide notice.
- Who the notice must be delivered to.
- When the insurer has not received notice, but has actual or constructive knowledge of a claim or loss.
- The effect of failure to provide notice.

The vast majority of insurance policies in California require that the insurer be provided with prompt notice of any potential claim.

Both claims made (including claims made and reported) and occurrence CGL policies include notice and reporting requirements. The significance and terms of these requirements often vary due to nature of the type of policies (for a discussion of both types of policies and the purpose of the notice requirements, see *Root v. Am. Equity Specialty Ins. Co.*, 130 Cal. App. 4th 926 (2005) and *Pac. Emp'rs Ins. Co. v. Superior Court*, 221 Cal. App. 3d 1348, 1356-60 (1990)). For both types of CGL policies, timely notice according to the terms of the policy allows the insurer to:

- Investigate the facts and circumstances surrounding the claim while they are timely and witnesses are still available.
- Prepare for a defense, if necessary.
- Decide whether it is prudent to settle the claim.

An **occurrence policy** provides coverage for events occurring during the policy period, even if the claim is brought years after the event occurred. Most occurrence-based CGL policies that impose a duty to defend on the insurer require the insured to:

- Provide the insurer with notice of a claim:
  - as soon as practicable;
  - at or about the time that the claim arises or becomes known to the insured; or
  - within a reasonable period of time after that period.
- Notify the insurer promptly when the insured is served process in a legal proceeding.
- Cooperate reasonably with the insurer in the investigation and defense of the claim.

In a **claims made policy**, coverage is provided for any covered claim made within the policy period or any applicable extended reporting period, regardless of when the negligent event or wrongful act occurred. Claims made policies typically require the claim be reported to the insurer promptly, but not necessarily within the policy period.

In a **claims made and reported policy**, coverage is provided for any covered claim that is made within the policy period **and** which is reported to the insurer within the policy period or any applicable extended reporting period. For example, some policies will provide coverage for claims asserted during the policy period and reported within 30 days after expiration of the policy (see, for example, *Westrec Marina Mgmt., Inc. v. Arrowood Indem. Co.*, 163 Cal. App. 4th 1387, 1389 (2008)).

Who Can Provide Notice

In California, it is irrelevant how and from whom the insurer receives notice of a claim. Whether the insurer learns of the claim from the insured, an additional insured, or even the plaintiff, it is deemed to be placed on notice of the claim (see, for example, *Security Ins. Co. v. Snyder-Lynch Motors, Inc.*, 183 Cal. App. 2d 574, 579 (1960), disapproved on other grounds by *Campbell v. Allstate Ins. Co.*, 60 Cal. 2d 303, 307 (1963) (holding that notice given by injured party to insurer inures to benefit of "additional insured")).

Who Must Notice Be Delivered To

As long as the carrier has constructive knowledge of the claim, the duty to defend is triggered (see Knowledge of Insurer). Therefore, regardless of the notice requirements expressly set forth in the policy, providing notice to any agent of the carrier, such as the insurance agent, should be sufficient. As stated in Cal. Civ. Code § 2332, "As against a principal, both principal and agent are deemed to have notice of whatever either has notice of, and ought, in good faith and the exercise of ordinary care and diligence, to communicate to the other."

Knowledge of Insurer

In California, constructive notice is sufficient to trigger the duty to defend (see *California Shoppers Inc. v. Royal Globe Ins. Co.*, 175 Cal. App. 3d 1 (1985) (stating "In short, the duty to defend, ordinarily arising after receipt of actual notice to do so, arose here upon receipt of constructive notice"); see also *Fresno Econ. Import Used Cars, Inc. v. United States Fid. & Guar. Co.*, 76 Cal. App. 3d 272, 278-79 (1977) and *Devin v. United Servs. Auto. Ass'n.*, 6 Cal. App. 4th 1149, 1157 (1992)).

However, constructive notice is typically not sufficient to support a bad faith claim, and the insured must make reasonable effort to comply with the reporting requirements of the policy (*Paulfrey v. Blue Chip Stamps*, 150 Cal. App. 3d 187, 199-200 (1983)).

Failure to Provide Notice

The implications of the failure to provide notice or failure to provide timely notice of a loss or claim to the insurer depends on the type of CGL policy (see *Pac. Emp'rs Ins. Co.*, 221 Cal. App. 3d at 1356-60).

Claims Made and Occurrence-Based Policies

For claims made and occurrence-based policies, California, along with the majority of jurisdictions in the

US, has adopted the notice-prejudice rule. Under this rule, late notice does not result in loss of coverage benefits unless the insurer proves by a preponderance of the evidence that the untimely notice prejudiced its interests. It should be noted that this applies only to claims made policies, and not to claims made and reported policies discussed below (see *Root*, 130 Cal. App. 4th 926 (discussing the difference between claims made and claims made and reported policies)).

In California, failure to provide prompt notice can jeopardize coverage if the insurer is prejudiced because of the delay. However, unless the carrier can show actual, substantial prejudice from the delay, while the delay could be a breach of the contract, it does not relieve the insurance carrier of its duty to perform. To show actual, substantial prejudice, the insurer must demonstrate that with timely notice, there would have been a substantial likelihood that either:

- It would have taken steps that would have substantially reduced or eliminated the insured's liability.
- The matter could have been settled for a smaller amount.

(*Belz v. Clarendon Am. Ins. Co.*, 158 Cal. App. 4th 615, 625-32 (2007).)

Claims Made and Reported Policies

For claims made and reported policies, proper notice within the reporting period provided under the terms of the policy is a condition precedent to coverage (see *Westrec Marina Mgmt.*, 163 Cal. App. 4th at 1393-96). Absent very limited equitable exceptions, claims made after the reporting period will not be covered (see *Root*, 130 Cal. App. 4th 926).

The notice-prejudice rule does not apply to claims made and reported CGL policies where there is a date-certain notice requirement. In a claims made and reported policy, coverage is provided for any covered claim that is made and reported to the insurer within the policy period or any applicable extended reporting period, regardless of when the negligent event or wrongful act occurred. Therefore, the date-certain notice requirement defines the scope of coverage and timely notice of a covered claim is the event that triggers coverage. Excusing late notice with this type of CGL policy defeats the fundamental concept on which coverage is premised and impermissibly rewrites a fundamental term of the insurance contract. *(Pac. Emp'rs Ins. Co.*, 221 Cal. App. 3d at 1359-60.)

Policy and Complaint Interpretation

3. In your jurisdiction, in determining whether there is a duty to defend, how do courts typically construe the insurance policy and the complaint? Specifically, please discuss:

- How courts resolve ambiguities in the insurance policy.
- Whether courts apply the four- or eight-corners rule and whether they consider extrinsic evidence.
- Whether courts consider amendments to the complaint.

Interpretation of Insurance Policies

In California, insurance agreements are construed under basic contract principles. The primary goal is to give effect to the mutual intention of the parties. As with other contracts the interpretation of an insurance policy is generally a question of law. (*Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 18 (1995).)

In construing insurance policies, the general principles of contract interpretation apply. Specifically:

- The policy must be interpreted to give effect to the parties' mutual intentions when the policy was entered into.
- The parties' intent is inferred from the policy's written provisions.
- Policy language is construed according to the plain and ordinary meaning of the terms.
- Dictionary definitions are considered in determining the plain and ordinary meaning of words used, but those definitions must be considered in light of the context of the policy.
- Policy language is interpreted broadly so as to afford the greatest possible protection to the insured.

(See *MacKinnon v. Truck Ins. Exch.* 31 Cal. 4th 635, 647-48 (2003); *Waller*, 11 Cal. 4th at 18; and *AIU Ins. Co. v. Superior Court (FMC Corp.)*, 51 Cal. 3d 807, 821-22 (1990)).

Policy Ambiguities

California courts view policy provisions as ambiguous when they are susceptible to more than one reasonable

interpretation. If ambiguity exists, the courts must construe the provisions in the way the insurer believed the insured understood them at the time the policy was purchased (Cal. Civ. Code § 1649). If ambiguities still exist, the ambiguous language will be construed against the party who caused the ambiguity and in the insurance context the courts:

- Construe the ambiguous language against the insurer, in favor of coverage.
- Interpret coverage provisions broadly to protect the reasonable expectations of the insured.
- Interpret exclusionary language narrowly against the insurer. The burden rests on the insurer to phrase coverage exceptions and exclusions in clear and unmistakable language.

(*Ameron Int'l. Corp.*, 50 Cal. 4th at 1378, as modified (Jan. 19, 2011); *MacKinnon*, 31 Cal. 4th at 647-48; and *AIU Ins. Co.*, 51 Cal. 3d at 821-22.)

Courts are not required to protect the insured to this degree from ambiguities if it is clear that all of the following are true:

- The policyholder is a sophisticated party with substantial bargaining power.
- The policy was jointly drafted.
- The policy was negotiated.

(*AIU Ins. Co.*, 51 Cal. 3d at 823 (discussing *Garcia v. Truck Ins. Exch.*, 36 Cal. 3d 426, 438 (1984)).)

Four Corners and Extrinsic Evidence

California courts look beyond the four corners of the complaint to determine if the duty to defend exists (see *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076, 1086 (1993)). To determine if coverage exists under the policy (including the duty to defend), California courts:

- Compare the allegations in the complaint with the policy language.
- Consider evidence extrinsic to the underlying complaint with respect to the duty to defend. Specifically, courts consider both extrinsic:
  - facts known to the insurer suggesting that coverage exists; and
  - evidence that provides undisputed facts that there is no coverage under the policy.
- Resolve any doubts as to whether coverage exists in the insured's favor.

(*Montrose Chem. Corp.*, 6 Cal. 4th at 295-00; see also *Waller*, 11 Cal. 4th at 19.)

Although courts do consider extrinsic evidence in making coverage determinations, they do not consider every conceivable fact that might exist (*Friedman Prof. Mgmt. Co., Inc. v. Norcal Mut. Ins. Co.*, 120 Cal. App. 4th 17, 34-35 (2004) (stating "The universe of facts bearing on whether a claim is potentially covered . . . does not include made up facts, just because those facts might naturally be supposed to exist along with the known facts")).

Amendments to Complaint

Consistent with the consideration of extrinsic facts, California courts do consider amendments to complaints in the coverage analysis (*Friedman Prof. Mgmt. Co.*, 120 Cal. App. 4th at 34-35).

4. In your jurisdiction, will the duty to defend exist even if allegations in the complaint are fraudulent or groundless?

Under California law, insurers are required to defend unsubstantiated, meritless, and even frivolous claims as long as a liability covered by the policy is asserted (*Horace Mann Ins. Co.*, 4 Cal. 4th at 1086; see also *Waller*, 11 Cal. 4th at 19 (stating, that the duty to defend applies "...even to claims that are 'groundless, false, or fraudulent'...").)

5. In your jurisdiction, who has the burden of proof in establishing the duty to defend?

In California, the insured bears the initial burden of establishing that the subject claim is covered under the policy language. The burden then shifts to the insurer to show that coverage is precluded under a particular exclusion, and accordingly, that it does not have a duty to defend. (*Collin v. Am. Empire Ins. Co.*, 21 Cal. App. 4th 787, 803 (1994).) If the insurer is able to show that the subject claim is excluded from coverage under the policy, the burden then shifts back to the insured to show that some exception to the exclusion results in coverage (*Aydin Corp. v. First State Ins. Co.*, 18 Cal. 4th 1183, 1192 (1998)).

6. What are the consequences if an insurer fails to defend a claim that is covered under the policy in your jurisdiction?

An insurer that refuses to indemnify or defend based on a belief that a claim against its insured is excluded from

a policy's scope of coverage, rather than defending under a reservation of rights, does so at its risk. If the insurer is incorrect, it bears the consequences, legal or otherwise, of its breach of contract. If the underlying claim against the insured is outside the policy's scope of coverage, then a liability insurer's refusal to indemnify or defend is justified.

Wrongful Failure and Bad Faith

In California, an insurer has a duty to investigate all claims tendered to it to determine if there is coverage under the policy, based in large part on the implied covenant of good faith and fair dealing (see *Graciano v. Mercury Gen. Corp.*, 231 Cal. App. 4th 414, 425 (2014), discussing the covenant generally).

Wrongful Failure

If an insurer erroneously determines that there is no coverage under the policy and rejects the claim, it runs the risk of being stuck with a judgment it did not defend. Upon rejection of a claim by the insurer, the insured has no further obligations under the policy (*Samson v. Transamerica Ins. Co.*, 30 Cal. 3d 220, 238 (1981)). In this situation the insured may defend the claim as it sees fit.

If both insured and the plaintiff believe that the rejection is improper, the insured can enter into a stipulated judgment and covenant not to execute and also assign its rights against the insurer to the plaintiff. If coverage should have been provided under the policy, the stipulated judgment will be binding on the insurer as to the insured's liability and the amount of damages unless the insurer can prove that the settlement was unreasonable or was the product of fraud or collusion. (*Pruyn v. Agric. Ins. Co.*, 36 Cal. App. 4th 500, 515 (1995).)

To help avoid this risk, the insurer may defend the case under a reservation of its rights to contest the existence or extent of coverage (see, for example, *Am Motorists Ins. Co. v. Allied-Sysco Food Servs., Inc.*, 19 Cal. App. 4th 1342, 1355-56 (1993) (holding that a proper reservation of rights was not issued so insurer had to pay for defense costs)). The reservation of rights letter notifies the insured that it may need to protect itself against the potentially non-covered claims. Depending on the nature of the allegations and the content of the reservation of rights letter, it may also trigger the insured's right to independent counsel (Cumis counsel, see Question 13). However, the reservation of rights letter in and of itself typically cannot support a bad faith claim. (*Griffin Dewatering Corp.*, 176 Cal. App. 4th at 215-16). For more information on reservation of rights letters, see Question 9.

To avoid allegations of bad faith, an insurer can also consider bringing a declaratory relief action while defending the insured under a reservation of rights. This way, the insurer can get a judicial determination as to whether coverage exists while avoiding the risks associated with a wrongful denial of coverage. To prevail in the declaratory relief action:

- The insured must prove the existence of some potential for coverage.
- The insurer must establish the absence of any potential for coverage whatsoever.

(*McMillin Homes Constr., Inc. v. Nat'l Fire & Marine Ins. Co.*, 35 Cal. App. 5th 1042, 1050 (2019).)

Bad Faith

Whether an insurer has breached the covenant of good faith and fair dealing typically depends on whether the carrier acted unreasonably (*Graciano*, 231 Cal. App. 4th at 425). If the insurer is found to have acted in bad faith, the insured may recover all damages proximately caused by the breach, including both contract and tort damages, regardless of policy limits (*Hamilton v. Maryland Cas. Co.*, 27 Cal. 4th 718, 725 (2002)). These damages can include:

- The amount the insured was forced to pay to resolve the case and the attorneys' fees expended defending the action (*Brandt v. Superior Court*, 37 Cal. 3d 813, 817 (1985)).
- Prejudgment interest (Cal. Civ. Code § 3287; see also *Howard v. Am. Nat'l Fire Ins. Co.*, 187 Cal. App. 4th 498, 535 (2010)).
- Tort damages (since extracontractual liability can attach) including:
  - damages for emotional distress (*Jordan v. Allstate Ins. Co.*, 148 Cal. App. 4th 1062, 1079 (2007)); and
  - punitive damages, if the insured can show that the insurer is guilty of oppression, fraud, or malice (Cal. Civil Code § 3294(a); see also *Cates Constr., Inc. v. Talbot Partners*, 21 Cal. 4th 28, 43-44 (1999)).

Typical areas where an insurer can be found to have acted in bad faith include failing to:

- Properly investigate a claim (*Williams v. Integon Nat'l Ins. Corp.*, 191 F. Supp. 3d 1126, 1132 (S.D. Cal 2016); *Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc.*, 78 Cal. App. 4th 847, 879-80 (2000)).
- Consider known facts, which, if true, would support coverage (*Amato v. Mercury Cas. Co.*, 53 Cal. App. 4th 825, 837-38 (1997)).

- Settle a claim within policy limits (*PPG Indus., Inc. v. Transamerica Ins. Co.*, 20 Cal. 4th 310, 314-15 (1999)).

7. In determining whether a duty to indemnify exists, how does your jurisdiction interpret insurance policies? Specifically, please discuss:

- The general rules of contract construction that courts apply.
- How courts handle ambiguities in the insurance policy.
- If courts consider the reasonable expectations of the insured.
- Whether coverage will be denied if the insured does not provide timely notice of a loss or claim.

The provisions and the language of the insurance policy govern the duty to indemnify. For information about how California courts interpret insurance policies, the general rules of contract construction, ambiguities in the insurance policy, and reasonable expectations, see Question 3.

For information regarding the failure to provide timely notice, see Question 2: Failure to Provide Notice.

Duty to Defend: Scope and Duration

8. In your jurisdiction, is the insurer required to defend against all claims in a suit even if they are not all covered claims (also sometimes referred to as "mixed claims")?

In California, if any claim is covered under the terms of the policy, the insurer must defend all claims asserted (*Buss*, 16 Cal. 4th at 48-49).

9. How is the insurer's duty to defend affected by a reservation of rights letter in your jurisdiction? Please discuss:

- The requirements for a valid reservation of rights letter.
- How a reservation of rights letter differs from a non-waiver agreement.
- Whether an insurer can reserve the right to be reimbursed for defense costs.
- Any relevant statutes and cases in your state.

The duty to defend is not per se affected by a reservation of rights. The purpose of a reservation of rights letter is to place the insured on notice of potential positions that the insurer is reserving with respect to coverage (*Ins. Co. of the West v. Haralambos Beverage Co.*, 195 Cal. App. 3d 1308, 1319-20 (1987) (insurer assuming defense of disputed claim may avoid waiving coverage defenses and avoid estoppel by providing sufficient and timely reservation of rights)). The letter puts the insured on notice that it may need to protect itself against the potentially noncovered claims. Depending on the nature of the allegations and the content of the reservation of rights letter, it may also trigger the insured's right to independent counsel.

Requirements for a Valid Reservation of Rights Letter

Insurers should make certain that reservation of rights letters:

- Are clear.
- Expressly identify all positions and rights the insurer wishes to reserve. This includes the rights to:
  - deny coverage and withdraw the defense;
  - seek an allocation and reimbursement of fees, costs, and settlement/judgment; and
  - seek a declaratory judgment.
- Identify:
  - the case name;
  - the case number;
  - the claim number; and
  - the policy number.
- Summarize the allegations of the complaint and any other pertinent facts.
- Specifically identify the policy language under which the insurer may wish to assert a coverage defense.
- In situations where the reservation of rights triggers a conflict requiring the appointment of Cumis counsel, that too should be noted (see Question 13).

The reservation of rights letter must include the following statement to comply with California Insurance Regulations:

"If you believe that all or part of this claim has been wrongfully denied or rejected, you may have the matter reviewed by the California Department of Insurance. The address and telephone numbers of the appropriate unit at

the Department of Insurance is: California Department of Insurance, Consumer Communications Bureau, 300 South Spring Street, South Tower, Los Angeles, California 90013 (800) 927-4357 (213) 897-8921."

(Cal. Code Regs., tit. 10, § 2695.7.)

Reservation of Rights Versus Non-Waiver Agreement

In California, generally:

- A **nonwaiver agreement** is a written contract between the insurer and the insured providing that the insurer will defend a suit against the insured while reserving its right to assert nonliability under the policy at a later date.
- Under a **reservation of rights,** the insurer only needs to notify the insured that it is conducting the investigation and defense of the claim against the insured under a reservation of the right to assert policy defenses at a later time (see, however, Requirements for a Valid Reservation of Rights Letter). The insured's silence is typically deemed acquiescence.

(See *Michaelian v. State Comp. Ins. Fund*, 50 Cal. App. 4th 1093, 1108-09 (1996) (citing and discussing *Val's Painting & Drywall, Inc. v. Allstate Ins. Co.*, 53 Cal. App. 3d 576, 586 (1975)).)

Reserving for Defense Costs

Under California law, an insurer can seek reimbursement of defense fees and costs expended in the defense of non-covered claims. This right is implied in law as quasi contractual as to claims that are not potentially covered. However, in order to seek reimbursement, the insurer must reserve its rights to do so. (*Blue Ridge Ins. Co. v. Jacobsen*, 25 Cal. 4th 489, 501-02 (2001).) In an action involving mixed claims, the insurer has the burden of proof to show by a preponderance of the evidence what defense costs can be allocated solely to the claims that are not potentially covered. (Cal. Evid. Code, § 500; see also *Buss*, 16 Cal. 4th at 50-53.)

10. In your jurisdiction, if there are multiple insurers covering the insured, which one will have the duty to defend? Please also discuss how courts allocate costs when more than one policy is triggered and whether excess carriers ever have a duty to defend.

In California, if two primary policies are triggered for the same claim, each insurer has an independent, concurrent duty to defend (*Wausau Underwriters Ins. Co. v. Unigard Sec. Ins. Co.*, 68 Cal. App. 4th 1030, 1033-34 (1998); *Dart Indus., Inc. v. Commercial Union Ins. Co.*, 28 Cal. 4th 1059, 1078-79 (2002)). Excess carriers typically have no duty to defend until the primary insurance is exhausted (*Cmty. Redevelopment Agency v. Aetna Cas. & Sur. Co.*, 50 Cal. App. 4th 329, 339 (1996)).

Most liability policies include "other insurance" clauses, which dictate how fees, costs, and losses should be allocated among the insurers where there is concurrent coverage. Some of these clauses state that the insurer will not have a duty to defend if there is any other coverage available, however such provisions are not favored for public policy reasons. Under California law, if concurrent policies include this type of other insurance clause, the insurers are often required to contribute pro rata to their policy limits. This is not always the case, however, and allocations may be made based upon other considerations such as length of coverage. (See *Dart Indus.*, 28 Cal. 4th at 1079-80; *Signal Cos., Inc. v. Harbor Ins. Co.*, 27 Cal. 3d 359, 369 (1980); for more information on "other insurance" clauses, see Question 17.)

The courts are given broad discretion to make equitable decision in such matters (*Scottsdale Ins. Co. v. Century Sur. Co.*, 182 Cal.App.4th 1023, 1032 (2010)).

11. When is the duty to defend terminated in your jurisdiction? Specifically, please discuss:

- Whether an insurer's tender of policy limits ends the duty to defend.
- Whether the insurer must defend through the finality of the action.
- Whether an insurer's settlement of the third-party claim against the insured terminates the duty to defend.
- Whether the duty to defend is terminated if the insured breaches a provision of the insurance contract.

California views the duty to defend as a continuing duty that starts when the defense is tendered, and continues until any of the following occur:

- The underlying action is concluded.
- It can be shown that there is no potential for coverage under the policy.
- The policy limits are exhausted.

(*Montrose Chem. Corp.*, 6 Cal. 4th at 295.)

An insurer can generally only terminate its duty to defend prospectively and not retroactively (*GGIS Ins. Servs., Inc. v. Superior Court*, 168 Cal. App. 4th 1493, 1505 (2008)). Only if the insurer never had a duty to defend (specifically, there was never any potential for coverage) may the insurer recover defense costs expended prior to the determination of non-coverage (*Buss*, 16 Cal. 4th at 50 (stating that an insurer can seek to recover defense costs spent on claims that are not even potentially covered by the policy)).

Tender of Policy Limits

Absent policy language expressly stating that the insurer's duty to defend terminates upon exhaustion of policy limits, under California law the insurer's duty to defend will continue until resolution of the claim in its entirety, even after the policy limits have been exhausted through the payment of settlements or judgments.

Under a "self-consuming" or "burning limits" policy, however, the duty to defend terminates once policy limits have been expended (*Aerojet-Gen. Corp. v. Transport Indem. Co.*, 17 Cal. 4th 38, 76, n.29 (1997)).

Finality of Action

Under California law, the duty to defend continues until either:

- The underlying action is concluded.
- It can be shown that there is no potential for coverage under the policy.

(*Montrose Chem. Corp.*, 6 Cal. 4th at 295.)

The conclusion of an action generally includes the exhaustion of all appellate rights.

Settlement of the Third-Party Claim

Once the third party claim is settled there is nothing left for the insurer to defend. However, where there are multiple third party claims, the settlement of one will not affect the defense of the others unless the result of the settlement is that the policy limits are depleted. In addition, some policies will have an indemnity cap for certain types of claims, and once that amount has been paid in indemnity there is no further duty to defend those types of claims.

Insured's Breach of Contract

Insured's Obligations

Typical insurance policies provide for certain obligations on the part of the insured. For example, most policies typically:

- Include a notice provision requiring the insured to:
  - inform the insurer promptly of any claims or actions; and
  - immediately forward any legal papers, claim notices, or demands to the insurer.

  (See Question 2.)
- Require that the insured cooperate in the investigation, settlement, or defense of a claim or action.

(See *Truck Ins. Exch. v. Unigard Ins. Co.*, 79 Cal. App. 4th 966, 974-76 (2000).)

Failure to Cooperate

If an insured fails to cooperate in the defense of the action, the insurer can avoid its indemnity obligations if it can show **all** of the following:

- That the insured failed to cooperate in the defense of the lawsuit against it.
- That the insurer used reasonable efforts to obtain the insured's cooperation.
- That the insurer was prejudiced by the insured's failure to cooperate in the defense. To establish prejudice, the insurer must show a substantial likelihood that, if the insured had cooperated, either:
  - the insurer would have taken steps that would have substantially reduced or eliminated the insured's liability; or
  - the matter could have been settled for a substantially smaller amount.

(See Judicial Council Of California Civil Jury Instruction 2321, CACI No. 2321.)

As a practical matter, an insured's failure to cooperate in the defense of the claim typically does not relieve the insurer of its duty to defend. This is because, in order for an insurer to successfully assert a failure to cooperate defense, it must show prejudice (specifically, that had the insured cooperated it would have achieved a better result such as a lower settlement or defense verdict) (see *Billington v. Interinsurance Exch. of Southern California*, 71 Cal. 2d 728, 737 (1969)). Obviously if the insurer does not defend, showing that the result would have been different had the insured cooperated would be difficult if not impossible.

Insurer Intervention

The insurer may be required to intervene in a lawsuit against its insured as a party in an attempt to overcome the effect of the insured's non-cooperation. If an insured

cannot defend a lawsuit (for example where the insured has died or is a suspended corporation) or refuses to cooperate in the defense, the insurer is entitled to intervene in the lawsuit to defend the insured's liability and contest the plaintiff's damages (*Executive Risk Indem., Inc. v. Jones*, 171 Cal. App. 4th 319, 333-34, n.11 (2009); Rutter Group, Insurance Litigation, ¶ 15:42 et seq.). If the insurer intervenes it will not be bound by any default judgment against the insured (*Western Heritage Ins. Co. v. Superior Ct.*, 199 Cal. App. 4th 1196, 1211 (2011)). The insurer's intervention essentially seeks a declaratory judgment against the plaintiff.

If an insurer has notice of a lawsuit and knowledge that the insured cannot or will not defend it, and the insurer does not intervene, the failure to intervene is substantial evidence that the insurer was not prejudiced by a default judgment against the insured because the insurer could have intervened to contest liability and damages (*Nasongkhla v. Gonzalez*, 29 Cal. App. 4th Supp. 1, *4, n.2 (1994); see also *Clemmer v. Hartford Ins. Co.*, 22 Cal. 3d 865 (1998) (overruled on other grounds by *Ryan v. Rosenfeld*, 3 Cal. 5th 124 (2017)).)

Default by Insured

Under California law, an insurer is liable to pay a default judgment against its insured (otherwise covered by the policy) unless it can show that its defense was substantially prejudiced by the default (*Belz*, 158 Cal. App. 4th 615). In *Belz*, the insured failed to notify its insurer of a lawsuit and allowed a default judgment to be entered. The plaintiff sought to enforce the default judgment against the insurer. The trial court granted summary judgment for the insurer, finding that insurers are not liable to pay default judgments. The Court of Appeal reversed, holding that the insurer was required to establish that it was substantially prejudiced by the default in order to avoid the obligation to pay the resulting default judgment. To prove substantial prejudice, an insurer must show that there would have been a substantial likelihood that either:

- It would have taken steps that would have substantially reduced or eliminated the insured's liability.
- The matter could have been settled for a smaller amount.

(*Belz*, 158 Cal. App. 4th at 625-32.)

12. In your jurisdiction, when, if ever, are insurers permitted to withdraw their defense?

Generally speaking, an insurer can withdraw its defense any time it determines that no coverage exists. However, if the insurer has undertaken the defense without reserving a known right, it may be deemed to have waived, or as being estopped from raising, that right (*DeWitt v. Monterey Ins. Co.*, 204 Cal. App. 4th 233, 245-46 (2012)). Therefore, insurers typically reserve their rights, including the right to withdraw from the insured's defense, and seek reimbursement of defense costs incurred regarding non-covered claims (*Johansen v. California State Auto. Assn. Inter-Ins. Bureau*, 15 Cal. 3d 9, 19 (1975)).

An insurer may also file a declaratory relief action, seeking a court determination on coverage and the duty to defend. While declaratory relief actions have expedited procedure rules, because of the time it takes to obtain declaratory relief, insurers will typically defend under a reservation of rights while seeking declaratory relief. For more information on reservation of rights, see Question 9.

Defense and Costs

13. In your jurisdiction, does an insured have the right to independent counsel?

In California, if there is a potential conflict of interest between insurer and insured, the insured is entitled to independent counsel (Cal. Civ. Code § 2860). This is typically referred to as "Cumis" counsel based upon the case entitled *San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc.* (162 Cal. App. 3d 358 (1984)).

Generally speaking, the right to independent counsel only arises if the actions of counsel in the defense of the underlying case can impact coverage. An insurer that unreasonably fails to provide independent counsel can be held liable for bad faith (see *Janopaul + Block Cos., LLC v. Superior Court*, 200 Cal. App. 4th 1239, 1248 (2011)).

14. In your jurisdiction, can an insurer recover defense costs that are spent defending uncovered claims?

In an action asserting both covered and non-covered claims, the insurer is obligated to defend both covered and non-covered claims (see Question 8). The insurer may, however:

- Seek allocation of defense fees and costs as between the covered and non-covered claims.

- Obtain reimbursement of those defense costs that can be allocated solely to the non-covered claims (non-covered claims being those that are not even potentially covered).

(See *Buss*, 16 Cal. 4th at 49-53.)

Duty to Indemnify: Causation

15. Do courts in your jurisdiction require a duty to indemnify if a loss has multiple causes, one or more of which is excluded from coverage? Please address whether a policy exclusion is effective whether or not there is any causal connection between the excluded risk and the loss.

If a loss has multiple causes, one or more of which are excluded from coverage, California courts apply the "efficient proximate cause rule" to determine if the insurer has a duty to indemnify. The efficient proximate cause rule provides that

- The loss is **covered** if the most important or predominant cause (the "efficient proximate cause") of the loss is a covered cause, even if an excluded peril may have contributed to that loss.
- The claim is **not covered** if the efficient proximate cause of the loss is excluded from coverage.

(Cal. Ins. Code § 530; see also *Garvey v. State Farm Fire & Cas. Co.*, 48 Cal. 3d 395, 401-04 (1989).)

The insurer has the burden to prove that the loss was caused by an excluded or non-covered peril (*Vardanyan v. AMCO Ins. Co.*, 243 Cal. App. 4th 779, 796-97 (2015)).

Under California law, policy provisions that conflict with Cal. Ins. Code § 530 and the efficient proximate cause doctrine (referred to as anti-concurrent cause provisions) are not enforceable (see *Julian v. Hartford Underwriters Ins. Co.*, 35 Cal. 4th 747, 754 (2005)).

Duty to Indemnify: Scope

16. Discuss whether your jurisdiction permits insurance companies to provide coverage and indemnification for:

- Punitive damages.
- Intentional damage or injury.

For public policy reasons, California does not permit an insurance company to provide coverage for punitive damages or intentional wrongdoing (see *PPG Indus., Inc.*, 20 Cal. 4th at 317 (stating that since punitive damages are awarded for punishment and deterrence, "...such damages rest ultimately as well as nominally on the party actually responsible for the wrong. If a party were allowed to shift such damages to an insurance company, punitive damages would serve no useful purpose"); see also *Waller*, 11 Cal. 4th at 18 (stating "...by statute, and as a matter of public policy, the insurer may not provide coverage for willful injuries by the insured against a third party")).

17. How does your jurisdiction view policy provisions that limit coverage if the insured has other insurance available?

Insurance agreements typically include an "other insurance" provision attempting to limit the insurer's liability in the event that another insurance policy covers the same loss (*Olympic Ins. Co. v. Emp'rs Surplus Lines Ins. Co.*, 126 Cal. App. 3d 593, 598 (1981)).There are several types of "other insurance" provisions:

- **Pro rata**, which provides that the insurer's liability is limited to the proportion of that insurer's policy limits to the total coverage available to the insured.
- **Excess only**, which require the exhaustion of other insurance, essentially changing a primary carrier into an excess carrier.
- **Escape clauses**, which extinguish the insurer's liability if the loss is covered by other insurance.

(See *Olympic Ins. Co.*, 126 Cal. App. 3d at 598.)

Application of these provisions has been the subject of significant litigation in California. The bulk of the decisions hold that regardless of the language of the clauses, the policies will "pro-rate" with the result that the insurers share the loss (see, for example, *Dart Indus.*, 28 Cal. 4th 1059; *Travelers Cas. & Surety Co. v. Century Surety Co.*, 118 Cal. App. 4th 1156 (2004); *Edmonson Prop. Mgmt. v. Kwock*, 156 Cal. App. 4th 197 (2007); *Certain Underwriters at Lloyds, London v. Arch Specialty Ins. Co.*, 246 Cal. App. 4th 418 (2016); *Underwriters of Interest Subscribing to Policy Number A15274001 v. ProBuilders Specialty Ins. Co.*, 241 Cal. App. 4th 721 (2015); *Advent, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 6 Cal. App. 5th 443 (2016), all providing extensive discussion of "other insurance" clause matters).

18. In your jurisdiction, can an insurer deny coverage of a settlement entered into by the insured on the grounds that the settlement was not authorized by the insurer?

CGL policy language typically used in California includes a provision known as a "no voluntary payment" provision. This type of provision generally states "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent" (see, for example, Insurance Services Office (ISO) Commercial General Liability Coverage Form CG 00 01 04 13, MILLERS-POL CGGL1, Section IV.2.d). California courts typically enforce these provisions unless the insurer breached a duty to the insured or if there was some economic necessity on the part of the insured (see *Jamestown Builders*, 77 Cal. App. 4th at 346-47).

If the insurer wrongly denies coverage and fails to defend, however, the insurer will be bound by a settlement by or judgment against the insured absent fraud or collusion between the insured and the claimant (*Pruyn*, 36 Cal. App. 4th at 515; for more information on the insurer's failure to defend, see Question 6).

Other Issues

19. Are there any other statutes, rules, cases, or issues in your jurisdiction that insurers or insureds should be aware of in determining whether a duty to defend or duty to indemnify exists?

There are no other statutes, rules, cases, or issues particular to California that relate to the duty to defend and the duty to indemnify.