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Insurance—Duty to Defend—Conflict of Interests: Harbin v. Assurance Co. of America, 308 F.2d 748 (10th Cir. 1962)

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INSURANCE—DUTY TO DEFEND—CONFLICT OF INTERESTS.*—What facts must be considered by the insurer in determining its obligation to assume the defense of a suit brought against its insured by an injured party? Most jurisdictions hold that the insurer's duty to defend is determined by facts alleged in the complaint of the injured party.[1] But some of these courts do not limit the facts used to those in the complaint when such facts do not reflect the actual facts of the dispute.[2] The Tenth Circuit Court of Appeals has adopted the rule[3] that actual facts determine the insurer's duty to defend when such facts are known to the insurer,[4] or when they might be determined by reasonable investigation.[5]

Harbin v. Assurance Co. of America[6] originated in the federal district court in New Mexico. The company sought a declaratory judgment to determine its duty to defend a state court action against its insured for assault and battery.[7] The complaint, which was filed after the insured had been convicted

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* Harbin v. Assurance Co. of America, 308 F.2d 748 (10th Cir. 1962).

1. See 50 ALR 2d 458, 465 (1956) for a collection of cases following the majority rule.

2. See 50 ALR 2d 458, 497-504 (1956). Jurisdictions holding that allegations of the complaint govern when actual facts differ from those alleged in the complaint of a third party include California, District of Columbia, Massachusetts, Mississippi, New York, Ohio, Rhode Island and South Carolina. Jurisdictions which view the actual facts of the dispute as controlling include Missouri, New York, Oklahoma, Pennsylvania and Texas. An example of the rationale of courts which view actual facts as controlling appears in the case of State v. Bland, 190 S.W. 2d 227, (Mo. 1945):

> We do not think that an insurance company can ignore actual facts (known to it or which could be known from a reasonable investigation) in determining its liability to defend . . . (We mean by actual facts the facts which were known, or should have been reasonably apparent at the commencement of the suit and not proof made therein or the final result reached.)

See note 23 *infra*.

3. Although it might be argued that the "rule" that actual facts control is but an exception, the more logical view is that:

> When adopted by a court, [the rule that actual facts control] . . . really replaces the general rule in all cases rather than merely being an exception in certain cases. It simply says that the actual ascertainable facts prevail instead of the alleged facts—the company must look beyond the complaint.

Cahoon, *Company's Duty to Defend—Recent Developments,* 1961 Ins. L.J. 151, 153.

4. Albuquerque Gravel Prods. Co. v. American Employers Ins. Co., 282 F.2d 218 (10th Cir. 1960), and Hardware Mut. Cas. Co. v. Hilderbrandt 119 F.2d 291 (10th Cir. 1941).

5. American Motorists Ins. Co. v. Southwestern Greyhound Lines, Inc., 283 F.2d 648 (10th Cir. 1960).

6. 308 F.2d 748 (10th Cir. 1962).

7. In an Oregon case involving duty to defend, the supreme court of that state held: "[A]ssault and battery amounts to an allegation that he was charged with committing a criminal act, in other words, that he was guilty of an intentional attempt by force and violence to do injury to the person of another, coupled with . . . present ability . . . and consumated by hostile, unpermitted physical contact with the person. MacDonald v. United Pac. Ins. Co., 210 Ore. 395, 311 P.2d 425, 426-27 (1957).

of criminal assault,[8] alleged only intentional conduct.[9] The insured's answer[10] denied all allegations of the complaint, and raised the defense of self defense.[11] The company refused to defend the action on the ground that the policy specifically excluded from coverage any intentional acts committed by the insured.[12] The federal district court granted summary judgment in favor of the

8. Record, p. 16. The complaint indicated that a dispute had arisen between the parties, as neighbors, concerning an unfenced swimming pool owned by the defendant. An argument between the parties resulted in defendant pushing plaintiff to the ground.

9. The complaint alleged that the insured (defendant in the declaratory judgment action) "did wilfully, maliciously and wrongfully assault, strike and beat Plaintiff with great force and violence." Record, p. 3.

10. The language of the answer reads as follows, Record, p. 15:

> Second Defense
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> That at the time of the alleged assault described in plaintiff's Complaint, the defendant was holding his infant daughter in his arms and if his acts and conduct constitutes an assault, which defendant denies, then such assault with [sic] justified in that the plaintiff's acts and conduct lead [sic] defendant to believe his own acts were reasonably necessary to protect his own person and that of his infant daughter.
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> Third Defense
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> That at the time of the alleged assault, the plaintiff was advancing on the defendant in a threatening manner and the defendant in defending himself and his infant daughter did necessarily and unavoidably place his hands upon plaintiff and push him away with force which was no more than was reasonably necessary to prevent the defendant and his infant daughter from being injured by plaintiff; that thereupon the plaintiff apparently slipped and fell to the pavement.

11. In Thomas v. American Universal Ins. Co., 80 R.I. 129, 93 A.2d 309 (1952) the court held that the question of whether the insured could avoid liability in an assault and battery action on the ground of self defense was of no concern to the insurer, only to the insured himself. The court held that, under the rule that allegations in the petition govern the insurer's duty to defend, the insurer could not be liable. Self defense becomes important where the language of an insurance policy specifically excludes not all intentional acts but only assault and battry committeed by or at the direction of the insured. Self defense in such a case would not be an assault and battery, and would be covered by the policy. See also McGettrick v. Fidelity & Cas. Co., 24 F.2d 883 (2d Cir. 1959) where the court held that the insurer in that case was under a duty to investigate in order to determine whether the insured committed an assault and battery or was only acting in self defense.

12. The policy in question was a comprehensive dwelling policy which provided coverage for comprehensive personal liability, and provided, *inter alia,* Record, pp. 1, 2:

> A. Bodily Injury; Property Damage: This company agrees to pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person, and as damages because of injury to or destruction of property, including the loss of use thereof.
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> * * *
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> C. Defense, Settlement, Supplementary Payments: With respect to such insurance as is afforded by this policy under this Division, this company shall:
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> (a) defend any suit against the insured alleging such injury, sickness,

company. On appeal to the Tenth Circuit Court of Appeals, *held,* affirmed, with the modification that the determination was not conclusive on the parties.

The insured unsuccessfully contended on appeal that the insurer's obligation to defend could not have been determined from the allegations of the complaint but required an investigation by the insurer which, if conducted, would have shown the insured's conduct to be unintentional. The court of appeals ruled that the burden of determining the intent of the insured should be placed on the trier of fact in the state court action and not upon the insurer by requiring an investigation.[13] Judge Breitenstein ruled that the insurer properly refused to defend the action because the policy imposed no liability on the insurer for injuries caused by the intentional act alleged in the complaint.[14] In addition, the court held that the insurer could not defend the state court action and at the same time protect both its own interests and the interests of its insured, for this would create a *conflict of interests.*[15] The court concluded by stating that the decision was not conclusive; if it should be determined by the state court

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disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but this company may make such investigation, negotiation, and settlement of any claim or suit as it deems expedient;

* * *

Special Exclusions Applicable to Coverage Group C.
This coverage does not apply:

* * *

(c) to injury, sickness, disease, death or destruction caused intentionally by or at the direction of the insured.

13. The insurer's liability depends on whether the injury was caused intentionally by the insured. The difficulty in the ascertainment of a state of mind needs no amplification. Reassonable men may understandably differ as to the intent of another because they may draw conflicting inferences from physical facts. For this reason the argument that the insurer should have conducted an investigation and relied on the results thereof does not persuade us. Intent is to be determined, not by the insurer's investigators, but by the finder of the facts in the lawsuit brought by the claimant of the injuries.
308 F.2d at 749-50.

14. The court found that the rights of the parties were fixed by terms of the policy. The language of the policy issued to the insured required that the insurer defend all suits "alleging" injury covered by the terms of the policy. See note 12, *supra.* The court found that: "The record before us shows that in the state court action judgment is sought for injuries resulting from an intentional assault. The policy imposes no liability on the insurer for such injuries." 308 F.2d at 750.

15. Judge Breitenstein stated:

If [the insurer] tries to exculpate [himself] by showing an intentional injury, it exposes the insured to a greater liability and a possible award of exemplary damages. If [the insurer] urges an unintentional injury, it foregoes the exclusionary provision of the policy. In such circumstances the control of the defense by the insurer and the assumption of such control without a reservation of the right to deny liability would have obligated the insurer to pay within the policy limits if the plaintiff should succeed.
308 F.2d at 749.

that the claim was within the policy coverage,[16] the company would be obligated to satisfy any judgment within the limits of the policy.[17]

Three previous Tenth Circuit cases holding that actual facts control over facts alleged in the complaint were distinguished by the court.[18] Two of these were properly distinguished;[19] the action in each sought to impose liability on the insured *after* the facts relieving the insurer were established.[20] The third

16. It is open to speculation whether language such as "facts as established" as used by the court would include facts which although not within the pleadings, are accepted into evidence without objection. Under the Federal Rules of Civil Procedure and N.M. Stat. Ann. § 21-1-1 (15) (b) (1953), such evidence "shall be treated in all respects as if [the issue raised by the evidence] had been raised in the pleadings."

17. Cases which discuss the duty of the insurer to defend state that no obligation to pay arises until the obligation to defend the action is established. The insurer would not be liable therefore, for any costs of defense incurred by the insured before the insurer's obligation arose.

Rule 15(c) of the Federal Rules of Civil Procedure and N.M. Stat. Ann. § 21-1-1 (15) (c) (1953) provides, however, that if the claim or defense asserted in the amended pleadings arises out of the same transaction or occurrence set forth in the original pleading, it relates back to the date of the original pleading. Moore, in his treatise on federal practice, states that "while 'relation back' is generally applied only with reference to the statute of limitations, the concept may also find application in other contexts." 3 Moore, Federal Practice 855 (2d ed. 1948).

The question remains open as to whether "relation back" would require the insurer to assume all costs of defense.

18. Hardware Mut. Cas. Co. v. Hilderbrandt, 119 F.2d 291 (10th Cir. 1941); Albuquerque Gravel Prods. Co. v. American Employers Ins. Co., 282 F.2d 218 (10th Cir. 1960); American Motorists Ins. Co. v. Southwestern Greyhound Lines, Inc., 283 F.2d 648 (10th Cir. 1960).

19. Hardware Mut. Cas. Co. v. Hilderbrandt, *supra* note 18; and, Albuquerque Gravel Prods. Co. v. American Employers Ins. Co., *supra* note 18.

The statement that these cases were properly distinguished is based upon the assumption that "established facts" refers to those facts which were present in the first action involved in each case. The language used by the court in setting out the distinguishing factors is ambiguous. It reads: "These cases are not controlling because in each the action sought to impose liability on the insurer after the facts had been established and in two of them the established facts were contrary to the complaint allegations. In the case at bar we meet the question on the threshold before the facts are established." 308 F.2d at 749. The court, by its use of "established facts" might mean either those established in the first action (Third party v. Insured) or those established in the second action (Insured v. Insurer). Since duty to defend arises only in the first action, the logical conclusion is that the court must have been referring to the facts of that action.

20. In Hardware Mut. Cas. Co. v. Hilderbrandt, 119 F.2d 291 (10th Cir. 1941), the insurance policy contained an exclusion which exempted employees from coverage. The insurer, although he had actual knowledge that the injured parties were not employees, disregarded this fact and refused to defend an action wherein the complaint alleged that the injured parties were employees. After settlement of the suit, the insured brought an action for breach of contract against the insurer. Upon rehearing, after judgment of the trial court for the insurer had been affirmed, the court vacated the decision that allegations of the petition govern duty to defend and ruled that allegations of the complaint do not govern when actual facts, which differ from those alleged, are known to the insurer.

In Albuquerque Gravel Prods. Co. v. American Employers Ins. Co. 282 F.2d 218 (10th Cir. 1960), the court followed the rule as stated in *Hardware Mutual,* even though the facts in the case were not disputed.

case, *American Motorists Ins. Co. v. Southwestern Greyhound Lines, Inc.*,[21] was an action by Greyhound to recover from its insurer, by way of indemnity, sums paid in settlement of an action brought by parties injured while alighting from a bus. Appealing from an adverse judgment, the insurer contended that the complaints of the injured parties alleged an injury specifically excluded from coverage under the insured's policy,[22] thereby absolving the insurer from its obligation to assume the defense of the action. The court of appeals affirmed the trial court's decision and ruled that the insurer was chargeable with knowledge of actual facts which could have been determined through a reasonable investigation.[23]

That *Greyhound* was properly distinguished by the Harbin court on the ground that the *established*[24] facts were contrary to the allegations in the complaint, is questionable. The facts in *Greyhound* were not established; they were in dispute at the time the insurer refused to defend the action, just as they were in *Harbin*. In addition, the insurer in both cases refused to defend on the ground that the complaints did not allege facts which would bring the action within the coverage of the policies. Thus, *Greyhound* should have controlled

21. 383 F.2d 648 (10th Cir. 1960).

22. The insurance policy in question expressly excluded from coverage any injuries sustained by passengers while alighting from buses. Implicit from the jury finding is the conclusion that they believed that the plaintiff fell after reaching the station platform.

23. The *American Motorists* court recognized the rule of Hardware Mut. Cas. Co. v. Hilderbrant, 119 F.2d 291 (10th Cir. 1941), but expanded that rule by stating: "[T]hat rule has been exprssly enlarged in Missouri to include both actual facts known to the insuranc company and those which could be learned through a reasonable investigation. Marshall's U.S. Auto Supply v. Maryland Casualty Co., 354 Mo. 455, 189 S.W.2d 529."

The court in the *Marshall's U.S. Auto Supply* case reasoned as follows: "We do not think that an insurance company can ignore actual facts (known to it or which could be known from reasonable investigation) .... (We mean by actual facts the facts which were known, or should have been reasonably apparent at the commencement of the suit and not the proof made therein or the final result reached)." *Id.* at 531.

The language in parentheses above was not necessary for a decision in that case, since from the allegations of the complaint the third party waived his right to benefits under workman's compensation and sued for damages for "occupational" disease. Such diseases were specifically excluded from coverage in the insurance policy written by the defendant insurer. No investigation was necessary, therefore, to determine the right to defense of the action.

Similar expansion of the exception to the general rule appeared in Texas. In Massachusetts Bonding and Ins. Co. v. Roessler, 112 S.W.2d 275 (Tex. Civ. App. 1938) it was held that the insurer, after independent investigation which disclosed that facts alleged in the complaint were untrue, could not ignore the defense of its insured because of the erroneous facts which eliminated coverage under the policy. Subsequently, the court in Trinity Universal Ins. Co. v. Bethancourt, 331 S.W.2d 943 (Tex. Civ. App. 1959) held that the insurer in that case was under a duty to ascertain the facts of the alleged cause of action before declining the defense of the suit, and cited the *Roessler* case, *supra*, as authority for this statement.

24. See note 19 *supra*.

Harbin,[25] were it not for the fact that the allegations of the injured party's complaint in *Harbin* alleged only *intentional* conduct. Because intentional conduct was alleged, the court concluded that the insurer could not absolve itself from liability by showing an intentional injury without exposing the insured to greater liability through exemplary damages.[26] By its decision, the Tenth Circuit adopted the doctrine of "conflict of interests," as established in the cases of *Farm Bureau Mut. Automobile Ins. Co. v. Hammer*,[27] and *Stout v. Grain Dealers Mut. Ins. Co.* [28]

In *Farm Bureau*, the insurer brought a declaratory judgment action to determine its obligation to defend an action brought against it by representatives of an injured party.[29] Farm Bureau had agreed to defend an action in *negligence* brought against its insured, but withdrew from the action before trial when the insured was convicted of second degree murder for intentionally causing an automobile collision. The Fourth Circuit Court of Appeals ruled that the insurer had no duty to continue the defense of its insured because of the insured's established intentional conduct; the insurer could not defend its insured and also protect its own interests without creating a conflict of interests.[30]

> [The insurer] could not exculpate itself by showing that the injurious acts of the insured were beyond the scope of the policy, for this showing would establish the liability of the insured to the injured parties to an even greater extent than that claimed in the complaints.[31]

25. The importance of discussing the cases distinguished is that the rule of the Tenth Circuit which has been developed is controlling in situations not falling within the rule of conflict of interests, or within the rational of *Harbin*.

26. See note 15 *supra*.

27. 177 F.2d 793 (4th Cir. 1949).

28. 201 F.Supp. 647 (M.D.N.C. 1962).

29. Defendants had received judgment from the insured in a suit for negligence, to which the insurer was not a party. Suit was brought against the insurance company when judgments assessed against the insured could not be collected. The trial court held that the insurer had a duty to defend its insured. He based his decision upon the well settled rule that: "Where an indemnitor [insurer] has notice of an opportunity to defend an action against his indemnitee [insured], he is bound by material facts established against the indemnitee whether he appeared in the defense of the action or not." Farm Bureau Mut. Automobile Ins. Co. v. Hammer, 177 F.2d 793, 799 (4th Cir. 1949). The Circuit Court of Appeals, however, did not see fit to apply the rule, because "[I]t extends the principle to a situation to which it does not apply and overlooks the true ground on which the principle is based." *Ibid.* The conditions of the policy would have been nullified, if the company were not only bound to defend any action for damages alleged to have been caused by accident due to neglect, but should thereby be estopped to show in any court that the damages were intentionally caused by the criminal conduct of the insured.

30. The court found that the expression of the rule constituted a limitation to the duty to defend, which was based upon the statement that "A third party cannot be called upon to defend an action where his showing himself not to be liable will not necessarily result in a judgment in favor of a party asking him to defend." *Id.* at 800.

31. *Id.* at 801.

In addition, the *Farm Bureau* court declared that it was against public policy to permit an insured to profit by his own wrong, as he would have if the insurer were required to defend him.

The rule of *Farm Bureau* was applied in the *Stout v. Grain Dealers Mutual* case,[32] a wrongful death action against the insured to recover damages for both *negligent* and *intentional* injury.[33] The insured had previously pleaded guilty to manslaughter and was convicted of that crime. Grain Dealers Mutual refused to defend the action on the ground that the policy excluded death caused by the insured.[34] The federal district court sitting in Maryland held in favor of Grain Dealers Mutual. It followed the considerations that had motivated the *Farm Bureau* court in its decision: (1) If the company were required to defend the insured, its interests would be directly opposed to his;[35] and (2) Public policy forbids an insured from profiting by his own wrongdoing.

Thus, in both *Farm Bureau* and *Stout,* the conflict of interests became important because negligence was alleged in the injured party's complaints after the intent of the insureds had been shown by prior adjudications. The insurers could not protect their interests and at the same time protect the interests of their insureds. In protecting their own interests, they would have to show that the insureds' conduct was intentional, thereby exposing the insureds to punitive liability. In *Harbin,* however, the complaint alleged only intentional conduct and sought punitive damages. If the company were to exculpate itself by showing that the conduct of the insured was intentional, in reliance upon the previous adjudication, there would be *no* possibility of exposing the insured to greater liability than was sought in the complaint. The "conflict of interests" rule therefore, should not have applied to the facts as stated in *Harbin.*

The rule of conflict of interests would only become important if the complaint was amended to include negligence. At such time, the company would be placed in the same position as the insurers in *Farm Bureau* and *Stout,* for by showing intentional conduct the company might expose the insured to greater liability. The application of the rule of conflict of interests if there should be

32. 201 F. Supp. 647 (M.D.N.C. 1962).

33. The court in *Stout* found that the allegations of negligence were mere conclusions which would not require the insurer to defend. The discussion on the allegations of negligence was, according to the court, superfluous since they believed that the decision in *Farm Bureau Mut. Automobile Ins. Co. v. Hammer* would be controlling without regard to the merits of the allegations of negligence.

34. The policy in question was a comprehensive personal liability policy which excluded from coverage all acts "caused intentionally, by or at the direction of the insured." 201 F. Supp. at 648.

35. The judge of the district court ruled that: "The insurance company in the present case would be in a position of defending Stout with his right hand by showing that there was no intentional or negligent injury while with his left hand he would be attempting to show that there was no coverage because it was an intentional injury." *Id.* at 649.

an amendment of the complaint would preclude the possibility that the company, at a later time, might have to assume the defense of its insured. This result supports the decision of the court that the company's only obligation would be to pay the judgment if the determination is made by the state court that the action is within the coverage afforded by the policy.

The result in *Harbin* is correct. Investigation should not be required when nothing could be gained by such investigation. And, to require the insurer to defend an action alleging injuries for which the policy imposes no liability on the insured, would obligate the insurer, without reservation of right to deny liability, to pay any resulting judgment up to the amount of the policy limits. In addition, the language of the policy issued to the insured provided that only suits alleging injuries covered by the policy would be defended by the company.

The rule of conflict of interests should be limited to facts like those in *Farm Bureau* and *Stout*. In all other cases, with the exception of the particular facts of *Harbin,* the duty to investigate as required by the *Greyhound* case would appear to control the duty to defend an action against an insured.

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