The Duty To Defend—Groundless, False, or Fraudulent

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The Insurance Services Office, Inc. (ISO), 1973-edition comprehensive general liability (CGL) insurance policy underwent numerous and substantial changes in 1986 as part of ISO's Commercial Lines Policy and Rating Simplification Project.[1] While most of the changes in the 1986 ISO CGL were extensively documented by ISO in its publications as well as by insurance and legal commentators, there was one change that garnered little attention: the 1986 ISO CGL insuring agreement left out entirely the phrase "groundless, false, or fraudulent" as a condition of the insurer's right and duty to defend.

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The 1973 CGL policy expressly required the insurer to defend any suit "even if any of the allegations of the suit are groundless, false or fraudulent," whereas the 1986 CGL (and all later editions) required the insurer to "defend the insured against any 'suit,'" with no mention of "groundless, false, or fraudulent" suits.

This has caused some to question whether it was ISO's intent to *narrow* the duty to defend by leaving out the phrase "groundless, false, or fraudulent." In a recent article written by an attorney for an East Coast law firm, the author recommended that business owners request "groundless, false, or fraudulent" wording be added to their liability policies to avoid the risk of losing defense coverage under the "eight-corners rule."

Groundless, False, or Fraudulent—Its Purpose

The purpose of the "groundless, false or fraudulent" wording found in the 1973 ISO CGL insuring agreement[2] is to make clear that an insurer cannot avoid its duty to defend by simply asserting that the allegations against the insured are without proper legal grounds, are frivolous or based on incorrect facts, or are intentionally misstated.

Here is one court's explanation:

> It must be kept in mind that we are not dealing with whether the **complaint alleges a viable cause of action** but whether the complaint **alleges facts giving rise to an insurer's duty to defend and indemnify** (which includes a duty to defend groundless claims). (Emphasis added.) *Garvis v. Employers Mut. Cas. Co.,* 497 N.W.2d 254 (Minn. 1993)

In other words, an insurer's own conclusion as to the relative merits of the allegations in the suit is not a basis for the insurer's refusal to defend its insured.

> An insured buys liability insurance in large part to secure a defense against *all* claims potentially within policy coverage,**even frivolous claims unjustly brought**…. we note that when the underlying action is a sham, the insurer can demur or obtain summary judgment on its insured's behalf and thereby obviate the necessity of further defense. (Emphasis added.) *Horace Mann Ins. Co. v. Barbara B.,* 846 P.2d 792 (Cal. 1993)

Nonetheless, the words "fraudulent, false, or fraudulent" do not mean the insurer's duty to defend extends to any and all suits against an insured.

Groundless, False, or Fraudulent—Its Limitations

The meaning of the phrase "groundless, false, or fraudulent" is frequently tested when the suit alleges only the types of claims *excluded* by the CGL policy.

The argument by the insured is that, while the allegation may fall entirely within an exclusion to the CGL, because the allegations themselves are without legal grounds, are frivolous, or are based on facts that are either demonstrably incorrect or intentionally misstated, the insurer is still obligated to defend an *otherwise excluded* claim. Here is one example—an insured was alleged to have kidnapped and sexually assaulted another—a claim that was excluded by the liability policy at issue. Nonetheless, the insured argued that *because* the allegations were clearly false and groundless, the insurer was still obligated to defend the excluded claim.

> Relying on the policy provision obligating Tradewind to "provide a defense at [its] expense by counsel of [its] choice, even if the suit is groundless, false, or fraudulent" Florencio points to these "inconsistencies in Lapina's story" to demonstrate that her assault claim was frivolous.
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> Florencio misapprehends this policy provision. **The provision clearly does not mean that an insurer is obligated to defend a suit because it is allegedly frivolous;** rather, the provision obligates an insurer to defend a suit "*[i]f* a claim is made or a suit is brought against an insured for damages because of bodily injury ... caused by an occurrence **to which [the] coverage applies" even if the suit is "groundless, false, or fraudulent."**
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> The duty to defend "groundless" claims is not extended without limit and **"requires a defense of only those claims covered by the policy."** Since the assault claim is not within the occurrence language, as we have explained, **it is not covered even assuming the claim was groundless.** (Emphasis added.) *Bayudan v. Tradewind Ins. Co., Ltd.,* 957 P.2d 1061 (Haw. Ct. App. 1998).

In the above case, the court found the insured's argument to be based on a misinterpretation of the meaning of "groundless, false, or fraudulent" when read in the full context of the insuring agreement, and thus, the insured's argument was erroneous. The insurer was not obligated to defend the insured, despite the groundless, false, or fraudulent wording, because all of the allegations were related to kidnapping and sexual assault, which were excluded by the policy.

In other words, whether the allegations are true or not, or whether the allegations have valid legal grounds, has no bearing on whether the allegations are *potentially* covered by the policy. And the determination of whether the allegations in a suit are *potentially* covered is the measure of an insurer's duty to defend its insured.

As a general matter, an insurer's duty to defend is only triggered for those claims *potentially covered* by the policy—and an insurer is not obligated to defend claims not covered by the policy *regardless of whether or not* the allegations are groundless, false, or fraudulent.

> However, the duty to defend groundless claims only applies when the claims, if not groundless, might be covered. **There is no duty to defend against allegations which, whether true or false, are clearly beyond policy coverage.** (Emphasis added.) *Horace Mann Ins. Co. v. Barbara B.,* 846 P.2d 792 (Cal. 1993)

Thus, the correct interpretation as to the *limitations* applicable to the obligation to defend "groundless, false, or fraudulent" claims in a CGL insuring agreement may be summarized by the following:

> As with all generalizations, the duty to defend is not without limit and an insurer cannot be properly required to defend litigation unrelated to the risks it has insured against. The duty to defend "groundless" claims is not extended without limit and **requires a defense of only those claims covered by the policy.** (Emphasis added.) Appleman, *Insurance Law and Practice,* ed. Berdal, vol. 7C, § 4684, 7273, 88.

Today's ISO CGL Policy

Do ISO CGL policies with edition dates of 1986 or later provide a narrower duty to defend? In other words, by leaving out the "groundless, false, or fraudulent" wording, is an insurer using today's ISO CGL policy allowed to avoid defense of claims against its insured by unilaterally concluding that the allegations in a suit are frivolous or not viable? The short answer is no.

The analysis of the duty to defend has not changed—the CGL insurer's duty to defend is based on whether the allegations are *potentially* covered by the policy, not by whether the allegations are true, frivolous, or otherwise viable, a finding that is usually made at the end of the underlying litigation. The absence of "groundless, false, or fraudulent" in today's ISO CGL insuring agreement does not narrow the insurer's duty to defend an insured.

> In the 1973 CGL, the insurer's duty to defend is stated to apply to "even if any allegations of the suit are groundless, false, or fraudulent." There is no such explicit statement in the current CGL forms. However, they do state an insurer has right and duty to defend *any* "suit" seeking those damages. **The absence of the prior wording should not be interpreted to mean an insurer is relieved of the duty to defend groundless, false or fraudulent suits**

> **against the insured.** Of course, the complaint must contain allegations that are potentially within coverage. (Emphasis added.) Donald S. Malecki and Arthur L. Flitner, *Commercial General Liability,* 3rd ed. (The National Underwriter Company: 1990), 13.

The recommendation to add "groundless, false, or fraudulent" wording to today's CGL policy would likely not have made any difference in the insurer's obligation to defend its insured when considering the example upon which the recommendation was based—a restaurant was sued by a victim of an assault who alleged the restaurant served liquor to the assailant. As the restaurant did not purchase liquor liability coverage, the allegations by the victim, which were demonstrably false in that the restaurant did not serve the assailant liquor, were not *potentially* covered by the restaurant's CGL policy, and the insurer refused to defend. Aside from the obvious remedy that liquor liability coverage might have been purchased, as explained above, the notion that the CGL policy would have been extended to defend allegations not potentially covered by the CGL policy solely because the allegations were false is a misreading of the CGL policy, specifically a misinterpretation of the requirement to defend claims that are groundless, false, or fraudulent.

Conclusion

An insurer's obligation to defend its insured is determined by whether one or more allegations in a suit against its insured are potentially covered by the ISO CGL policy and not by whether the policy includes "groundless, false, or fraudulent" wording in the insuring agreement. A refusal to defend a claim based solely on the insurer's own conclusions as to the validity of the legal basis for the allegations or the veracity of the facts being alleged is not supported by the ISO CGL policy wording and thus not permitted. On the other hand, an insurer is not obligated to defend allegations against its insured that are *not potentially covered*by the ISO CGL policy solely *because* the allegations have no valid legal basis or the facts being alleged are false or fraudulent.

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[1]Introduction and Overview–Third Edition, April 1986, Commercial General Liability, Insurance Services Office, Inc.

[2]The phrase "groundless, false, or fraudulent" is still used today in other liability policies in connection with the insurer's defense obligations.

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