Duty to Defend - Maryland

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1. What triggers an insurer's duty to defend?

An insurer's duty to defend is triggered when three conditions are met: (1) where it contracts to defend in the policy; (2) where a "suit" has been filed against an insured; and (3) the allegations of the complaint potentially fall within the policy coverage. *Moscarillo v. Prof'l Risk Mgmt. Servs., Inc.*, 398 Md. 529, 537-38, 921 A.2d 245, 249-50 (2007) (citing *Brohawn v. Transamerica Ins. Co.,* 276 Md. 396, 407-08, 347 A.2d 842, 850 (1975)). The Maryland Court of Appeals first articulated the potentiality rule in *Brohawn*, *i.e.*:

> The obligation of an insurer to defend its insured under a contract provision... is determined by the allegations in the tort actions. If the plaintiffs in the tort suits allege a claim covered by the policy, the insurer has a duty to defend. Even if a tort plaintiff does not allege facts which clearly bring the claim within or without the policy coverage, the insurer still must defend if there is a *potentiality* that the claim could be covered by the policy.

Id. at 407-08, 347 A.2d at 850 (citations omitted) (emphasis added).

The Maryland Court of Appeals explained how to determine whether there was a potentiality of coverage in *St. Paul Fire & Marine Ins. Co. v. Pryseski*, 292 Md. 187, 193-94, 438 A.2d 282, 285 (1981), where the Court adopted the comparison test; that is:

> In determining whether a liability insurer has a duty to provide its insured with a defense in a tort suit, two types of questions ordinarily must be answered: (1) what is the coverage and what are the defenses under the terms and requirements of the insurance policy? (2) do the allegations in the tort action potentially bring the tort claim within the policy's coverage?

"Maryland does not follow the rule, adopted in many jurisdictions, that an insurance policy is to be construed most strongly against the insurer." *Cheney v. Bell Nat'l Life,* 315 Md. 761, 766-67, 556 A.2d 1135, 1138 (1989). Rather, insurance policies are construed like any other contract to determine the parties' intentions. *Sullins v. Allstate Ins. Co.*, 340 Md. 503, 508-09, 667 A.2d 617 (1995); *Connors v. Gov't Emps. Ins. Co.*, 216 Md. App. 418, 426, 88 A.2d 162, 166-67 (2014). Words are given their "customary, ordinary, and accepted meaning." *Cheney*, 315 Md. at 766, 556 A.2d at 1138. If policy terms are ambiguous, extrinsic and parol evidence may be considered to ascertain the intentions of the parties. *Sullins*, 340 Md. at 508-509, 667 A.2d at 619. If the policy terms remain ambiguous, they "will be construed liberally in favor of the insured and against the insurer as drafter of the instrument." *Megonnell v. U.S. Auto. Ass'n,* 368 Md. 633, 655-56, 796 A.2d 758, 772 (2002).

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An ambiguous allegation may give rise to a duty to defend. For example, if the allegations in the complaint do not specifically allege that the loss occurred during the policy period, there is a duty to defend. *S. Md. Agric. Ass'n v. Bituminous Cas. Corp.*, 539 F. Supp. 1295, 1304 (D. Md. 1982); *Harford Mut. Ins. v. Jacobson*, 73 Md. App. 670, 678, 536 A.2d 120, 124, *cert. denied*, 312 Md. 601, 541 A.2d 964 (1988). A second type of ambiguity may arise due to the vagueness of the policy language. *See, e.g., Sullins*, 340 Md. at 510, 667 A.2d at 619.

For occurrence policies, the duty to defend attaches when the occurrence happens. *Sherwood Brands Inc. v. Harford Accident & Indem. Co.*, 347 Md. 32, 41-42, 698 A.2d 1078, 1082-83 (1997). Under claims-made policies, the duty to defend attaches when the claim is made during the policy period. *Id*.

The duty to notify is not a condition precedent, but a mere covenant due to Maryland's notice-prejudice statute. *Id. See also* Md. Code Ann., Ins. § 19-110. The duty to defend is not breached until after the insurer receives notice of the event and the insurer unjustifiably declines to fulfill its obligations. *Sherwood Brands*, 347 Md. at 47, 698 A.2d at 1085-86. Tender need not be by the insured, but may be made by another on the insured's behalf to trigger a duty to defend. *Scottsdale Ins. Co. v. Am. Empire Surplus Lines Ins. Co.*, 791 F. Supp. 1079, 1084 (D. Md. 1992).

2. What type of proceedings must an insurer defend?

The Maryland Court of Appeals has not addressed directly the type of proceeding a liability insurer must defend.

In *Bausch & Lomb, Inc. v. Utica Mut. Ins. Co.*, 330 Md. 758, 780, 625 A.2d 1021, 1032 (1993), the Maryland Court of Appeals addressed an insurer's duty to indemnify where the insured "initiated the clean-up without legal proceedings having been formally filed against it by a third party, and with a written administrative directive by a government agency that it take such action." There, the "State agents did not adopt an overtly adversarial and coercive posture," "did not sue the company," and "issued no order." 330 Md. at 780, 625 A.2d at 1032. Yet, the Court found that:

> 'polite but puissant compulsion' may inhere to State regulatory activities, especially when, as here, the regulators actively monitor the clean-up. B & L ultimately faced the task of complying with the environmental laws, and paying the costs of compliance. As such, for the purposes of this analysis, we accept the trial court's finding that B & L's response costs, undertaken in the regulatory context, represented a sum the corporation was legally obligated to pay.

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Id. If there is a duty to indemnify, *a fortiori,* there is a duty to defend.

In *Liberty Mutual Insurance Co. v. Black & Decker Corp.*, 2005 WL 102964 (D. Mass. Jan. 13, 2005). A federal district court, applying Maryland law, concluded that Maryland would follow the same rationale as Massachusetts, set forth in *Hazen Paper Co. v. U.S. Fid. & Guar. Co.*, 407 Mass. 689, 555 N.E. 2d 576 (1990) and *Zecco, Inc. v. Travelers, Inc.*, 938 F. Supp. 65 (D. Mass. 1996). In Zecco, elucidating the rule in *Hazen Paper*, the court laid out several indicators that a pre-suit letter triggers an insurer's duty to defend: (1) "a failure to comply with the letter should itself somehow alter the substantiality of the insured's liability, by making liability more likely or more devastating or by giving rise to some particular penalty"; (2) "letters from governmental entities tend to have more severe consequences than those from private parties;" and (3) "a letter's tone is relevant, in-so-far as it indicates whether the offer to discuss matters is a polite invitation or one the recipient could not refuse." *Zecco*, 938 F. Supp. at 68.

A recent court applying Maryland law to construe whether "suit" encompassed a non-traditional proceeding was *National Union Fire Insurance Co. of Pittsburgh, PA v. Porter Hayden Co.*, 408 B.R. 66 (D. Md. 2009). There, Porter Hayden's bankruptcy plan called for the establishment of an Asbestos Bodily Injury Trust to handle asbestos-related claims against Porter-Hayden. *Id.* at 75. National Union contended, *inter alia*, that there was no "suit" against the insured, but the court disagreed finding that "suit" encompassed the claims filed with the Trust seeking damages for Porter Hayden's liability. The court noted that dictionaries offer different definitions of "suit," some of which refer to court proceedings, some refer to tribunals, but not necessarily courts of law. *Id.* Other "proceedings such as settlements, alternative dispute resolution, administrative determinations, etc., that may be construed as court proceedings . . ." may fall outside the dictionary definition of "suit." *Id.* Hence, the court concluded the term was ambiguous and construed it liberally in favor of the insured. *Id.*

Of course, where the policy terms include the defense of administrative or regulatory investigations, there is a duty to defend. ACE Am. Ins. Co. v. Ascend One Corp., 570 F. Supp. 2d 789 (D. Md. 2008) (administrative subpoena issued by Maryland Attorney General constituted filing of investigative orders or similar documents commencing "civil, administrative or regulatory investigations," and potentially within scope of E&O policy).

3. When is extrinsic evidence used to determine whether an insurer has a duty to defend?

As discussed above, if policy terms are ambiguous, extrinsic and parol evidence may be considered to ascertain the intentions of the parties. *Sullins*, 340 Md. at 508-09, 667 A.2d at 619.

An insured may rely on extrinsic evidence to establish a duty to defend where the claimant's allegations "neither conclusively establishes nor negates a potentiality of coverage." *Aetna Cas.*

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& Sur. Co. v. Cochran, 337 Md. 98, 108, 651 A.2d 859, 864 (1995). The extrinsic evidence must:

> relate in some manner to a cause of action actually alleged in the complaint and cannot be used by the insured to create a new, unasserted claim that would create a duty to defend. Unasserted causes of action that could potentially have been supported by the factual allegations or the extrinsic evidence cannot form the basis of a duty to defend because they do not demonstrate a reasonable potential that the issue triggering coverage will be generated at trial.

Moscarillo, 921 A.2d 245 (quoting *Walk v. Hartford Cas. Ins. Co.*, 381 Md. 1, 21-22, 852 A.2d 198, 210 (2004)).

Any uncertainty as to whether there is a duty to defend is resolved in favor of the insured. *Id.* at 107, 651 A.2d at 863-64. However, an insured must demonstrate that there is a reasonable potential that the issue triggering coverage will be generated at trial and a frivolous defense will not establish an insurer's duty to defend. *Id.* at 111-12, 651 A.2d at 866. Moreover, "the extrinsic evidence must . . . relate . . . to a cause of action *actually alleged* in the complaint and cannot be used by the insured to create a new, unasserted claim that would create a duty to defend." *Walk*, 382 Md. at 21, 852 A.2d at 110 (quoting *Reames v. State Farm Fire & Cas. Ins.*, 111 Md. App. 546, 561, 683 A.2d 179, 186 (1996).

Where the allegations of the complaint establish a potentiality of coverage, an insurer may not rely upon extrinsic evidence to deny coverage. *Cochran*, 337 Md. at 107-108, 651 A.2d at 864 (citing *Brohawn,* 276 Md. at 408, 347 A.2d at 850); *Balt. Gas & Electric Co. v. Commercial Union Ins. Co.*, 113 Md. App. 540, 567, 688 A.2d 496, 509 (1997). This includes whether the putative insured qualifies as an insured. *Ohio Cas. Ins. Co. v. Lee*, 62 Md. App. 176, 488 A.2d 988, *cert. denied*, 303 Md. 471, 494 A.2d 939 (1985).

There is an exception to this rule permitting an insurer to contest coverage with extrinsic evidence where there is uncontroverted evidence that clearly establishes that there is no potentiality for coverage. *N. Ins. Co. of N.Y. v. Balt. Bus. Commc'ns, Inc.*, 68 F. App'x 414, 420 (4th Cir. 2003). A court need not "turn a blind eye where, as here, it is firmly established by judicial decree that an insured tortfeasor is excluded from coverage under particular terms of the insurance policy." *Universal Underwriters Ins. Co. v. Lowe*, 135 Md. App. 122, 151, 761 A.2d 997, 1012 (2000).

4. What is the scope of an insurer's duty to defend?

An insurer must defend all counts of a multi-count complaint, even if only one claim is potentially covered by the policy. *Utica Mut. Ins. Co. v. Miller*, 130 Md. App. 373, 383, 746 A.2d 935, 940 (2000) (quoting *S. Md. Agric. Ass'n*, 539 F. Supp. at 1299). There is a limited and rarely applied exception where defense

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costs can be readily apportioned between covered and noncovered counts. *Loewenthal v. Sec. Ins. Co. of Hartford*, 50 Md. App. 112, 123 n.5, 436 A.2d 493, 499 n.5 (1990), *cert. denied*, 292 Md. 596 (1982).

Where there is a common core of facts or events giving rise to covered and noncovered injuries or claims under different legal theories, allocation is not permitted. Nor is there a right of allocation for defense costs incurred defending a non-covered claim where those costs were also necessary to defend a covered claim. *Fed. Realty Inv. Trust v. Pac. Ins. Co.*, 760 F. Supp. 533, 536-37 (D. Md. 1991); *Cont'l Cas. Co. v. Bd. of Educ. of Charles Cnty.*, 302 Md. 516, 489 A.2d 536 (1985).

The duty to defend is a continuing one that continues on appeal as long as reasonable grounds for an appeal exist. *Commercial Union Ins. Co. v. Porter Hayden Co.*, 116 Md. App. 605, 654-55, 698 A.2d 1167, 1191 (1997) (citing *Luppino v. Vigilant Ins. Co.*, 110 Md. App. 372, 382, 677 A.2d 617, 622 (1996), *aff'd*, 352 Md. 481, 723 A.2d 14 (1999)), *vacated*, 339 Md. 150, 661 A.2d 691 (1995).

5. When is an insurer responsible for pre-tender defense costs?

An insurer may be obligated to reimburse its insured for pre-notice costs unless it can show prejudice as a result of the delay. In *Sherwood Brands, Inc. v. Hartford Accident & Indem. Co.*, 347 Md. 32, 698 A.2d 1078 (1997), the Court held that the insurer's right to defend and the duty to defend "necessarily attaches as soon as there is something to defend." *Id.* at 47-48, 698 A.2d at 1085-86. As to the insured's notice of duty, the Court stated:

> Where the duty of notification is regarded as a condition precedent to the insurer's duty to defend, a holding that the duty to defend does not arise until the notice is given is logical; it rests on the very nature of a condition precedent. Where, as in Maryland, however, the duty to notify is *merely a covenant that, absent a showing of prejudice, does not excuse the insurer from complying with its duty to defend*, the logic of such a holding becomes significantly attenuated, for it creates a time gap between the insurer's right to control the defense and its duty to provide one that has no legal underpinning.

Id. at 45, 698 A.2d at 1084 (emphasis added). The Court concluded that the duty to defend arises when an insured claim is filed or an insured occurrence happens, but that such a duty is not breached until the insurer is apprised of the claim or occurrence and, without legal justification, fails to undertake the defense. *Id.* at 47, 698 A.2d at 1085. Hence, the insurer is liable for pre-tender defense costs, except to the extent it can show prejudice. *Id.* at 48-49, 698 A.2d at 1086. The Court set out several factors for determining whether the insurer was prejudiced by the delay: (1) was it reasonable for the insured to have incurred the expense; (2) was the expense reasonable; and

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(3) did the expense materially exceed what the insurer would likely have incurred had the notice been given earlier? *Id.* at 48-49, 698 A.2d at 1086. For example, a rate may be reasonable yet materially in excess of a rate a specific insurer has negotiated with competent counsel. *Id.* at 49 n.7, 698 A.2d at 1086 n.7. Each of these factors goes to the amount of defense costs, not liability for defense costs.

6. What is the extent of an insurer's obligation to defend when other insurers also have a duty to defend?

Where duplicative coverage is concurrent, that is, where it covers the same policy period, defense costs are shared the same way as indemnity; *i.e*. pursuant to the "other insurance" provisions. *See Ryder Truck Rental, Inc. v. Schapiro & Whitehouse*, 259 Md. 354, 364-65, 269 A.2d 826, 831-32 (1970); *Centennial Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 71 Md. App. 152, 164, 524 A.2d 110, 116 (1987), *cert. denied,* 310 Md. 491, 530 A.2d 273 (1987). Although no court has addressed how defense costs are to be shared with consecutive insurers, indemnity is shared upon a time-on-the-risk basis. *Mayor & City Council of Balt. v. Utica Mut. Ins. Co.*, 145 Md. App. 256, 302-03, 802 A.2d 1070, 1097-98 (2002), *cert. granted*, 371 Md. 613, 810 A.2d 961 (2002), *appeal dismissed*, 374 Md. 81, 821 A.2d 369 (2003).

7. When is there a right to independent counsel?

The issuance of a reservation of rights by the insurer does not automatically require independent counsel. *Driggs Corp. v. Pa. Mfrs. Ass'n Ins. Co.*, 3 F. Supp. 2d 657, 658-59 (D. Md. 1998); *Cardin v. Pac. Emps. Ins. Co.,* 745 F. Supp. 330, 336 (D. Md. 1990). A conflict as to whether there is a duty to indemnify the insured alone does not, while a conflict in the insurer's conduct of the defense does trigger a right to independent counsel. *Roussos v. Allstate Ins. Co.*, 104 Md. App 80, 90 655 A.2d 40, 44 (1995), *cert. denied*, 339 Md. 335, 663 A.2d 73 (1995), *cert. denied*, 517 U.S. 1107 (1996).

Where the claimant alleges both covered and noncovered counts, the insured and the insurer have diametrically opposed interests. The insurer's interest is to establish non-coverage and the insured's interest is to establish coverage. This is a type conflict of interest where the insurer must allow the insured to choose independent counsel. The seminal case on this point in Maryland is *Brohawn*, 276 Md. 396, 347 A.2d 842 (1975), where the complaint alleged negligence and assault (an intentional tort) in the alternative. The insured had previously pled guilty to assault charges. The Court reasoned that the insurer's selected counsel could defend on the basis that the guilty plea was an admission that the injuries were caused by an intentional act. This could result in a verdict against the insured on the noncovered intentional injury count and a dismissal of the negligence count. The *Brohawn* Court recognized that the rights of an insured could be adequately protected by the duties imposed upon the attorney by the Cannons of Professional Responsibility. However, the Court held

> that an insured is not deprived of his contractual right to have a defense provided by the insurer when a conflict of interest between the two arises under

> circumstances like those in this case. When such a conflict of interest arises, the insured must be informed of the nature of the conflict and given the right either to accept an independent attorney selected by the insurer or to select an attorney himself to conduct his defense. If the insured elects to choose his own attorney, the insurer must assume the reasonable costs of the defense provided.

276 Md. at 414-15, 347 A.2d. at 854.

One court found that independent counsel was unnecessary where the insurer-appointed counsel: (1) was instructed by the insurer to represent *only* the interests of the insured; (2) was at no time also representing the insurer in the case; and (3) had an ethical responsibility to work only on behalf of his client, no conflict of interest was created. *Driggs Corp.*, 3 F. Supp. 2d at 658-59; *Cardin,* 745 F. Supp. at 336-38.

A conflict as to how the case should be defended strategically, does not give rise to a right to independent counsel. *Nationwide Mut. Ins. Co. v. Webb*, 291 Md. 721, 741, 436 A.2d 465 (1981); *Roussos*, 104 Md. App. at 89-90, 655 A.2d at 44. Nor does a claim in excess of the policy limits. *Id.* Further an insurer's rejection of an offer to settle within the policy limits does not automatically create a conflict. *Allstate Ins. Co. v Campbell*, 334 Md. 381, 396, 639 A.2d 652, 659 (1994).

An insurer's rejection of an offer to settle within policy limits does not automatically create a conflict. *Campbell*, 334 Md. at 393-97, 639 A.2d at 658-60. The insurer must assume the *reasonable* costs of defense by an independent counsel where required due to a conflict between the insurer and the insured. *Id.* at 392, 639 A.2d at 657. The courts applying Maryland law have not examined what constitutes reasonable attorneys' fees.

8. **What right of recoupment of defense costs exists for an insurer?**

This issue has not been addressed by the Maryland appellate courts. However, the Fourth Circuit, applying Maryland law has found no right to recoupment. *Perdue Farms, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 448 F.3d 252, 258-59 (4th Cir. 2006).

9. **What are the consequences of an insurer's wrongful failure to defend?**

An insurer that wrongfully breaches its duty to defend is liable for the damages, including attorneys' fees, incurred by the insured as a result of the breach. *Mesmer v. Md. Auto. Ins. Fund,* 353 Md. 241, 252, 725 A.2d 1053, 1058 (1999); *Litz v. State Farm Fire & Cas. Co.,* 346 Md. 217, 232-33, 695 A.2d 566, 573 (1997). These attorney fees may be incurred in defending against the underlying tort claim or in a declaratory judgment action to determine coverage. *Id.*

An insurer that mistakenly refuses to defend is not estopped from denying its duty to indemnify. *Glens Falls Ins. Co. v. Am. Oil Co.*, 254 Md. 120, 136-37, 254 A.2d 658, 667 (1969). If it is found to cover the loss, it is bound by the judgment. *Id.*

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"A liability insurer's mistaken refusal to provide any defense whatsoever, on the grounds that there is no valid insurance contract or that there is no coverage under an insurance contract, gives rise to a breach of contract action against the insurer. It does not give rise to the tort action for an alleged bad faith failure to settle a third party claim against the insured." *Mesmer*, 353 Md. at 252, 725 A.2d at 1058.

10. **What terminates an insurer's duty to defend?**

    The duty to defend terminates when the claimant's "claim may be confined to non-covered allegations." *Balt. Gas & Electric*, 113 Md. App. at 572, 688 A.2d at 511-12. The courts applying Maryland insurance law have not addressed whether the duty to defend terminates when the policy limits are exhausted.

11. **If there is no duty to defend, can the insurer have a duty to indemnify?**

    If there is no duty to defend, there is no duty to indemnify. *Nautilus Ins. Co. v. REMAC Am., Inc.*, 956 F. Supp. 2d 674, 681-82 (D. Md. 2013).

12. **Are there any other notable cases or issues regarding the duty to defend that are important to the law of this jurisdiction?**

    None.

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