

MEALEY'S™ LITIGATION REPORT

Construction Defects Insurance

Construction Defect Claims: An Update

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Commentary

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By

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[Editor's Note: Thomas F. Segalla, Ellen H. Greiper, and Matthew S. Lerner are partners and Stefan A. Borovina and Marvin N. Romero are associates in the Construction, General Liability, and Global Insurance Services Practice Groups of the law firm Goldberg Segalla. The firm has 14 offices in New York, Illinois, Missouri, Connecticut, Pennsylvania, North Carolina, New Jersey, and the United Kingdom. Any commentary or opinions do not reflect the opinions of Goldberg Segalla or LexisNexis, Mealey's. Copyright © 2015 by Thomas F. Segalla, Ellen H. Greiper, and Matthew S. Lerner, Stefan A. Borovina and Marvin N. Romero. Responses are welcome.]

Decisions from various jurisdictions continue to emphasize the burden an insurance carrier is confronted with when disclaiming coverage. While it is well known that “the duty to defend is broader than the duty to indemnify,” the distinction is sometimes forgotten. When examining whether an insured is owed a defense by its insurance carrier, jurisdictions such as Illinois and Oregon will only review the underlying complaint and insurance policy. However, other jurisdictions, like Nevada, have not foreclosed the possibility that documents outside of the complaint can be considered. It is imperative that insurers understand the factors a court will consider prior to issuing a declination of coverage. Thus, if the disclaimer is challenged, the insurer can show the disclaimer was based solely on information and evidence that is admissible within the applicable jurisdiction.

During the writing of this report, Florida Governor Rick Scott signed a new bill – HB87 – that substantially

revises Florida's Construction Defect Act, Chapter 558. The changes to the Act include: (I) a revision to the legislative intent; (II) a revision of the definition of the term “completion of a building or improvement”; (III) an amendment that provides additional requirements for a notice of claim; (IV) a revision of the requirements for a response; and (V) a revision of provisions relating to the production of certain records. A summary of the changes is discussed below.

Below we report on the various cases that we believe have had a significant impact on litigants in the construction industry and facilitate an analysis to those involved in the construction industry and facilitate an analysis to those involved in construction defects disputes. If you have any questions or comments, please contact us by email or telephone.

Coverage

Arizona

Policy Exclusions — Insurers Burden To Establish Applicability Of Exclusions Satisfied

Pinnacle Pines Only. Ass'n v. Everest Nat'l Ins. Co., 2014 U.S. Dist. LEXIS 65011 (D. Ariz. May 9, 2014)

This coverage dispute stems from defendants Everest National Insurance Company (“Everest”) and Chartis Specialty Insurance Company’s (“Chartis”) objection to pay a \$1.37 million arbitration award plaintiff had obtained against defendants’ insured, Empire

Residential Construction LP and Empire Residential Sales LP ("Empire").

Everest argued that since the underlying wrap policy had a self-insured retention of \$250,000, which Empire had not paid, the failure to comply with the SIR acted as an exclusion under the policy. The Court reviewed the terms of Everest's policy and found that Empire's inability to pay the SIR did not absolve Everest from its responsibility to provide coverage. However, the Court also found no evidence that work on the allegedly damaged property was performed during Everest's policy period and therefore granted Everest's motion for summary judgment.

Chartis argued that plaintiff had not satisfied a \$1.0 million retention limit under the Chartis policy. Although there was some ambiguity in the language of the policy, the Court found that the \$1.0 million retained limit applied. It further held that the limit had not been satisfied since plaintiff's arbitration award included arbitration related fees and expenses that included only \$920,000 of covered property damage. As a result, Chartis was not liable to plaintiff for any property damage under the policy.

Practice Note: The Court indicated the general requirement that insureds bear the burden to establish coverage under an insuring clause, while the insurer bears the burden to establish the applicability of any exclusions.

California

Issues Of Fact Regarding Allegedly Mistaken Endorsement Precluded Summary Judgment As To Reformation Of The Policy

Century Sur. Co. v. Weir Bros. Constr. Corp., 2015 U.S. Dist. LEXIS 47240 (S.D. Cal. Apr. 9, 2015)

Plaintiff sued Defendant for reformation of a liability insurance policy and the deletion of an endorsement in the policy included by mistake. Plaintiff alleged that when it entered into the policy with Defendant, the parties intended to enter into a "claims made" policy. Because of the inclusion of the allegedly mistaken endorsement, however, the policy was converted into an "occurrence" policy. Defendant's counterclaims sought judicial determination that the policy issued by Plaintiff was valid and enforceable as written, and

that Defendant was entitled to a defense and recovery of fees in an underlying construction defect litigation. Defendant further sought compensatory and punitive damages for breach of the covenant of good faith based upon both Plaintiff's alleged attempt to reform the policy without valid legal grounds, as well as "dilatatory claims handling." Plaintiff subsequently filed a motion for summary judgment as to its claim for reformation, and against Defendant's two counterclaims, and prayer for punitive damages.

The Court denied Plaintiff's motion for summary judgment as to reformation, holding that Plaintiff failed to establish that the mutual intent of both parties was to exclude the subject endorsement. Specifically, the Court relied on the fact that the subject endorsement was included in the quote, binder, and policy because both parties intended for it to be so. Further, Defendant requested, and Plaintiff granted, the extension of the policy as written on two separate occasions. The Court also found that while Plaintiff failed to put forth any evidence as to its underwriters' intent as to the policy, Defendant showed its intent that the endorsement be included by tendering its defense in an underlying litigation. Plaintiff's burden aside, the Court found triable issues of fact as to Defendant's intent based upon a statement by Defendant's owner that it was not sure of the difference between the two types of policy, but instead purchased insurance from Plaintiff because it "offered the most coverage for the best price." Additionally, Defendant presented evidence that Plaintiff's employee referred to the policy as an "occurrence" policy in an insert to a letter giving Plaintiff notice of a potential claim in an underlying litigation.

Turning to Defendant's counterclaims, the Court first denied Plaintiff's motion for summary judgment as against Defendant's counterclaim for declaratory relief as to the policy's validity. Because Plaintiff's motion sought summary judgment under the reformed policy, and issues of fact existed as to reformation, the Court was unable to address summary judgment on the counterclaim.

As to Defendant's second counterclaim for breach of the covenant of good faith and prayer for punitive damages, the Court denied in part and granted in part. The Court first denied Plaintiff's motion with respect to the alleged breach of the covenant of good

faith. In doing so, the Court found an issue of fact as to whether Plaintiff unreasonably delayed in agreeing to defend Defendant in an underlying litigation when it received notice of a potential claim, acknowledged its obligation to defend pursuant to the existing policy, but then did not agree to defend Defendant until over three months later. Turning to Defendant's prayer for punitive damages, the Court granted Plaintiff summary judgment. The Court first found no evidence that Plaintiff was aware of and concealed from Defendant the endorsement converting the policy unto an "occurrence" policy. The Court further held that by bringing the instant action, Plaintiff was merely protecting its own interests in pursuing an equitable remedy. Because this conduct was not "despicable" and was not intended to injure Defendant, it did not warrant punitive damages. Finally, the Court held that although issues of fact may exist with respect to whether Plaintiff's delay in defending Defendant was unreasonable, there was no evidence of oppression, fraud, or malice as required for an award of punitive damages.

Practice Note: Plaintiff's apparent failure to read the policy issued to Defendant played an important role in the Court's decision. By failing to read the policy, Plaintiff failed to discover that the endorsement was included throughout the document. The fact that the endorsement was included throughout the entire policy raised the inference that the parties actually intended to include it.

California

Defective Construction Without Damage To Other Property Is Not Property Damage

Regional Steel Corp. v. Liberty Surplus Insurance Corp., 226 Cal. App. 4th 1377, 173 Cal. Rptr. 3d 91 (2014)

This coverage dispute stems from defendant Liberty Surplus Insurance Corp.'s ("Liberty") denial of defense to its insured. After plaintiff, a subcontractor, had commenced a lawsuit against the general contractor for non-payment and the general contractor filed a cross complaint asserting contract warranty and negligence claims. Plaintiff tendered its defense to Liberty, who denied coverage, asserting that the economic losses claimed did not constitute property damage within the meaning of the policy. Plaintiff commenced this declaratory judgment action and defendant moved for summary judgment.

The Court held that where defective workmanship is incorporated into construction projects, California courts consistently hold "that coverage does not exist where the only property damage is the defective construction and damage to other property has not occurred." Since the underlying action only alleged that the plaintiff had failed to install the proper tie hooks and its failure to do so required demolition and repair of the affected areas, the work was not covered under a CGL policy. The Court also held that the impaired property exclusion of the policy applied, as there was no coverage for property damage to "property that has not been physically injured" arising out of the plaintiff's negligent work. As a result, the Court granted defendant's motion for summary judgment.

Practice Note: The Court reviews what constitutes property damage on the impaired property exclusion.

Colorado

Sanctions For Improper Denial Of Defense To Insured

D.R. Horton Inc. v. Mt. State Mutual Casualty Company, 2014 U.S. Dist. LEXIS 132563 (D. Colo. Sept. 22, 2014)

In this case, the Court considered whether defendant insurer unreasonably delayed or denied payment of plaintiff's defense costs in an underlying construction defect action and, if so, what penalty should be imposed pursuant to Colorado statutes providing for statutory penalties.

The Court concluded that the defendant had a duty to defend plaintiff in the underlying construction defect action. It cited a Colorado statute that an insurer's duty to defend is triggered by a notice of defects such as the one served by the plaintiff in this action, regardless of whether another insurer may also have a duty to defend. The Court then addressed Colorado statute that provides a penalty of reasonable attorney's fees and court costs at two times the covered benefit when it is found that payment of benefits has been unreasonably delayed or denied and awarded a statutory penalty in accordance with that statute. The Court also granted plaintiff's attorney's fees and court costs in an amount to be determined after the Court's decision.

Practice Note: The Court's decision reflects that the duty to defend is greater than a duty to indemnify and, in Colorado, statutory penalties can be assessed for unreasonably delaying or denying a claim for payment of benefits.

Colorado

Court Clarifies Definition Of First-Party And Third-Party Claimants Under Statutory And Common Law

Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Intrawest ULC, 2015 U.S. Dist. LEXIS 34973 (D. Colo. Mar. 20, 2015)

Plaintiff sued Defendant for declaratory judgment as to its obligations under a CGL it issued to Defendant. A group of real estate developers, either covered under Plaintiff's policies or named as defendants in underlying lawsuits involving Plaintiff's policies, collectively made a motion to intervene. Interveners alleged multiple claims against Plaintiff including the violation of Colorado Revised Statutes § 10-3-1115 and § 10-3-1116 as well as common law bad faith. Plaintiff then made a motion to dismiss Interveners' statutory and common law claims.

In its motion for the dismissal of the statutory claim, Plaintiff argued that Interveners could not be considered "first-party" claimants because they asserted claims under a CGL policy, which was considered a "third-party" claim under common law. The Court disagreed, noting that the relevant part of the statute specifically defined first-party claims. The definition did not endorse any specific insured or type of policy that authorized a claim under the statute. The Court held that the plain language of the statute was controlling, and that Interveners were not precluded from asserting the statutory bad faith claim. As to the merits of the claim, Interveners argued that they were insured under Plaintiff's policies, which provided liability coverage benefits for construction defect claims including both indemnity and defense. They further argued that Plaintiff failed to provide those benefits by both by refusing to reimburse for settled underlying claims and threatening to withdraw its defense in pending underlying claims. Based upon these arguments, the Court agreed that Interveners sufficiently alleged that they were first-party claimants under the statute. The Court also

rejected Plaintiff's alternative argument that Interveners' claim had to be dismissed because it was at least partially based upon events that occurred before the statute took effect. While the Court noted that Interveners' claim was limited to acts that occurred after the enactment date, it could not conclude as a matter of law that none of plaintiff's alleged acts occurred after this date. The Court therefore denied Plaintiff's motion with respect to the dismissal of the stator claim.

As to Plaintiff's motion for the dismissal of Interveners' common law claim, Plaintiff argued that Interveners could not simultaneously exist as first-party claimants under the statute and third-party claimants under common law. The Court rejected this argument, again noting that "first-party claimant" was specifically defined in the statute. The Court then stated that because of the specific definition, Interveners' status under the statute had no bearing on their ability to bring a separate claim under common law. Turning to the remaining merits of the motion, the Court restated the Colorado rule that an insurer must deal in good faith with its insured. Specifically with third-party claims, the insured must show that it acted reasonably in paying or denying a settled third-party claim. The Court noted that numerous issues surrounding both the policy at issue and Plaintiff's conduct in dealing with Interveners' claims were in dispute. The Court was therefore unable to determine as a matter of law whether Plaintiff's conduct was reasonable. Because of this, the Court denied Plaintiff's motion to dismiss as to Interveners' common law claim.

Practice Note: In denying Plaintiff's motion, the Court also indicated that the statutes at issue specifically stated that they did not, and were not intended to, limit or affect other available claims, through common law.

Colorado

"Property Damage" — Defectively Installed Product Does Not Constitute "Property Damage"

Cool Sunshine Heating & Air Conditioning, Inc. v. Am. Family Mut. Ins. Co., 2014 U.S. Dist. LEXIS 174818 (D. Col., Dec. 17, 2014)

At issue in this case was the motion of the insured against the insurer based upon the insurer's refusal to defend the insured in a construction defect case. The

insurer cross-moved for summary judgment. The insured was sued in an underlying action wherein a homeowner alleged various defects to an air conditioning and heating system in their home. The insurer refused to defend and contended that the allegations in the underlying action fell within the Policy exclusion which excluded coverage for property damage which is limited to defects in the insured's own work product. The court held that the allegations did not constitute "property damage" and that they fell within the insured's work product exclusion.

Practice Note: The court reviews what constitutes property damage and the effect of the "your work product" exclusion.

Connecticut/Maryland/Virginia

Property Damage — Issues Of Fact

Am. Home Assur. Co. v. KBK Bldg. Corp., 2015 U.S. Dist. LEXIS 4076 (D. Md., Jan. 13, 2015)

In applying Connecticut law, specifically the case of *Capstone Building Corp. v. American Motorist Ins. Co.*, 308 Conn. 760 (Conn. 2013), the court denied and granted various summary judgment motions of the insurer. The insured incurred substantial costs in repairing its subcontractors' defective construction of two buildings and sought reimbursement for those expenses from its insurer. The insurer instituted this action and sought a declaration that it was not liable under its commercial general liability policies. It was the contention of the insurer that its insured was seeking indemnification for the cost it incurred in repairing its own defective work and therefore was not "property damage." The court noted that the parties had not supplied a precise breakdown between covered and non-covered costs and held that those costs will be determined at a later stage of the proceedings. Further, the court found issues of fact and denied the insurer's motion to the extent that the insured sought indemnity for repairs to cracked walls, lintels and piers, as well as the finishings applied to those services and loss of use caused by the cracking.

Practice Note: The court dismissed the insured's claim for a breach of the covenant of good faith and fair dealing and found that there was not any evidence of bad faith. "Clumsy" claims handling is insufficient.

Florida

Revision Of Florida's Construction Defect Act, Chapter 558

June 16, 2015

On June 16, 2015, Florida's Governor Rick Scott signed into law HB 87, a bill revising the construction defect claim process. This substantially revises Florida's Construction Defect Act, 558. The new law takes effect on October 1, 2015.

The amendment changes the construction defect notice statute by (1) revising the Act's legislative intent; (2) revising the definition of the term "completion of a building or improvement"; (3) providing additional requirements for a notice of claim; (4) revising the requirements for a response; and (5) revising provisions relative to the production of certain records.

As to the amendment of the legislative intent, the Act now includes language that adds insurers to the list of people who receive notice and an opportunity to resolve the claim. The statute also explicitly states that the claims can be resolved "through confidential settlement negotiations" without resorting to further legal process. The legislative intent for the revision is to "reduce the need for litigation as well as [to] protect the rights of property owners."

The amendment also includes language clarifying that temporary certificates of occupancy qualify under the definition of "completion of a building or improvement". The statute now defines the term as the "issuance of a certification of occupancy, whether temporary or otherwise, that allows for occupancy or use of for the entire building or improvement, or the equivalent authorization to occupy or use the improvement, issued by the governmental body having jurisdiction."

The amendment also sets forth additional requirements for a notice of claim. The Act now states that, at a minimum, the claimant must visually inspect the defect, describe it in reasonable detail as well as identify its location in the notice of claim. In addition, the claimant must describe the defect if the damage or loss resulting from the defect is known. There is no requirement to perform destructive or other testing for the notice of claim.

The amendment includes additional requirements for the contractor, subcontractor, supplier, or design professional for their response after servicing a claim. They must now serve a written report of the scope of any inspection of the property, the findings and results of the inspection, and one or more of the offers or statement specified in paragraphs (5)(a)-(e), as chosen by the responding contractor, subcontractor, supplier, or design professional, with all of the information required for that offer of statement.

The bill includes a revision to section 558.004, Florida Statutes, of the requirements for a response. Upon request, the claimant and any person served with notice has to exchange information detailing the defect.

Practice Note: The amendment to the Act is effective on October 1, 2015. Practitioners should note that the bill amends several aspects of the Act. A side-by-side comparison of the Act and the Act with amendment is recommended to understand the impact of the amendment.

Florida

Third-Party Beneficiaries Of Insurance Policies

Red Fish Key Villas Condo Association v. Amerisure Insurance Company, 2014 U.S. Dist. LEXIS 2478 (M.D. Fla. Jan. 9, 2014)

Plaintiff, a condominium association, commenced an action against a contractor's insurer to enforce a default judgment it had obtained against the contractor for defective construction. Defendant filed a motion to dismiss plaintiff's claim for damages for a material breach of duty on the basis that plaintiff was not a third-party beneficiary of the insurance policy. The Court held that the Florida Supreme Court has determined that liability insurance policies are inherently third-party beneficiary contracts, provided that a condition has been met prior to a third-party suit against the insurer - that the person not insured under the terms of the liability insurance contract first obtain a settlement or verdict against the person who is insured under the terms of the policy. As the plaintiff had obtained a default judgment against defendant's insured, it had satisfied the condition precedent and, therefore, defendant's motion to dismiss was denied.

Practice Note: This decision highlights that in Florida an injured third-party can commence a direct action

against an insurer as an intended third-party beneficiary, provided that it has first obtained a judgment or settlement against the insured.

Florida

Duty To Notify — Rebuttable Presumption Of Prejudice

Red Fish Key Villas Condo Association v. Amerisure Insurance Company, 2014 U.S. Dist. LEXIS 151111 (M.D. Fla. Oct. 24, 2014)

After the District Court refused to dismiss plaintiff's claim for damages as a third-party beneficiary of the policy, defendant made a motion for summary judgment, arguing that plaintiff was not entitled to recovery because its insured did not notify defendant of plaintiff's lawsuit as required by the insurance policy, and that the damages sought by plaintiff involved defective work of a subcontractor that was not covered under the policy. The Court found that the contract contained a requirement that the insured notify defendant both when a claim was made and when a lawsuit was filed. Although the insured had provided defendant with the construction defect claim notice, it found that it did not notify defendant of the lawsuit. The Court found, however, that plaintiff rebutted the presumption of prejudice, as defendant's ability to determine the existence of any construction defects and the responsible party responsible was not inhibited. The Court noted that defendant had access to substantial information regarding the claim and had submitted a pretrial stipulation stating that the insured's subcontractor had provided the defective work. The Court also rejected defendant's argument that the claimed damages were not covered under defendant's policy and denied defendant's motion for summary judgment.

Practice Note: Although lack of notice or the complete failure to notify an insurer creates a presumption of prejudice, the presumption can be rebutted if it can be established that the insurer's ability to evaluate its rights and liabilities, make a timely investigation and prevent fraud upon it were not affected.

Illinois

No "Occurrence" Or "Property Damage" To Trigger Coverage

Design Concrete Founds, Inc. v. Erie Ins. Prop. & Cas. Co., 2014 Ill. App. (5th) 130353-U; 2014 Ill. App. Unpub. LEXIS 2684 (Nov. 26, 2014)

In the underlying action, the insured was sued by homeowners for damage to their home that resulted from cracks that formed in the foundation which allowed water to leak to the basement and caused the foundation to shift. The insurer refused to defend the insured in the underlying action and advised that there was no coverage under the primary or umbrella policy because the allegation in the underlying action did not constitute an "occurrence" or "property damage." The court held that the underlying complaint did not constitute an "occurrence" under the primary CGL policy or umbrella policy and therefore, there was no duty to defend. The court further concluded that the allegations on the underlying complaint did not constitute "property damage."

Practice Note: The court in reaching its decision discussed the "true but unpleaded facts principle" and held that the insured did not present sufficient evidentiary proof to establish a claim.

Illinois

The Duty To Defend Requires Allegations Of Specific Facts

Valley Fire Prot. Sys., LLC v. Phoenix Ins. Co., 2015 U.S. Dist. LEXIS 30609 (N.D. Ill. Mar. 12, 2015)

Plaintiff sued Defendant for allegedly failing to defend Plaintiff in an underlying lawsuit, breaching its duty to defend, and for violating Illinois' bad faith statute. Plaintiff was a subcontractor in the underlying lawsuit that designed and installed allegedly defective fire protection system in an office building. Pipes in the fire protection system eventually leaked and needed to be replaced. Defendant had previously issued a CGL to Plaintiff, but denied coverage and refused to defend Plaintiff in the lawsuit. After the denial, Plaintiff settled the underlying lawsuit, and thereafter sued Defendant.

Defendant, in a motion for judgment on the pleadings, argued that it had no duty to defend Plaintiff because the underlying claim did not allege "property damage" caused by an "occurrence" as required by the policy. Specifically, Plaintiff's complaint was limited to the repair and replacement of the defective sprinkler system, and did not allege any water damage to other parts of the building. Plaintiff argued that because its complaint alleged that the sprinkler system substantially and

chronically leaked inside the office building, it was implied that water damage occurred within the building. Granting the Defendant's motion, the Court disregarded Plaintiff's implied allegations of water damage and held that if a "complaint alleges no specific facts within or potentially within coverage, there is no duty to defend."

Practice Note: In reaching its decision, the Court acknowledged that, although it was obligated to liberally construe the complaint in favor of the insured Plaintiff, it could not speculate about possible factual scenarios not alleged in the claim. It also could not read facts into the complaint that were not there.

Mississippi

Duty To Defend

Carl E. Woodward LLC v. Acceptance Indemnity Insurance Company, 743 F.3d 91 (5th Cir. 2014)

This coverage dispute stems from defendant Acceptance Indemnity Insurance Company's disclaimer of defense and indemnity to plaintiff, a general contractor, as an additional insured under a commercial general liability ("CGL") policy. The Fifth Circuit Court of Appeals held that Acceptance did not have a duty to defend or indemnify Woodward.

In reaching its decision, the Fifth Circuit noted that under Mississippi law, when determining whether an insurer has a duty to defend, courts must examine the language of the policy with the facts alleged in the complaint. The Court noted that the CGL policy contained two provisions affecting the scope of coverage. One established coverage for matters "arising out of DCM's ongoing operations," while the other excluded property damage that occurred after all work at the site had been completed.

In determining whether Woodward's liability arose out of DCM's ongoing operations or its completed operations, the Court examined the facts alleged in the complaint/cross claims against Woodward in the construction defect action. Claims sounding in fraud, defamation and breach of contract did not arise out of DCM's ongoing operations. The Court also noted that construction defect claims arise out of a subcontractor's completed operations. As the policy excluded

completed operations, Woodward was not an additional insured under the CGL policy.

Practice Note: In its decision, the Court noted that Mississippi has two different insurance products, a CGL policy and a performance bond. The Court noted that CGL policies serve limited purposes that cover accidental occurrences during construction, while a performance bond guarantees the completion of the general contractor's work on the project.

Nevada

Burden Of Disclaiming Coverage

National Fire & Marine Insurance Company v. Redland Insurance Company, 2014 U.S. Dist. LEXIS 107382 (D. Nev. Aug. 4, 2014)

This case concerns a coverage dispute wherein plaintiff alleged that it was entitled to equitable contribution from defendant for the defense fees and costs it incurred on behalf of an insured in an underlying construction defect lawsuit. The defendant moved for summary judgment alleging that they were not required to provide coverage because their policies required "an occurrence resulting in property damage during the policy period" for the policies to apply.

Under Nevada law an insurer bears a duty to defend an insured whenever it ascertains facts that give rise to potential for coverage under the policy. If there is any doubt as to whether coverage exists, the doubt must be resolved in favor of the insured and coverage provided. Additionally, any limitation in the policy must be "clearly and distinctly" communicated to the insured. The Court found that defendant's policies clearly and distinctly communicated that they required "property damage" during the policy period to trigger coverage. The Court found, however, that the complaint in the underlying action did not allege that the property damage occurred at any particular time. Since the date on which the property damage occurred could not be determined from the underlying complaint, it was not possible to state that the damage had not occurred during the relevant policy periods. As a result, the Court denied defendant's motion for summary judgment.

Practice Note: The Court's decision highlights the heavy burden that an insurer has when disclaiming coverage. To disclaim coverage, an insurer must ensure

that there is no potential for arguable or possible coverage under the policy. In reaching its decision, the Court examined the complaint in the underlying action, as well as evidence outside of the complaint, and nonetheless found that the insurer's burden had not been satisfied.

Nevada

Reservation Of Rights Does Not Equate To A Breach Of Insurer's Duties Under A Policy

Probuilders Specialty Ins. Co. v. Double M. Constr., 2015 U.S. Dist. LEXIS 34039 (D. Nev. Mar. 17, 2015)

Plaintiff sued Defendant for declaratory relief with respect to an underlying construction defect action involving numerous policies where Defendant was a named insured. Plaintiff had previously assumed the full defense of Defendant in the underlying action while also maintaining a complete reservation of rights. Plaintiff sought a declaration that it owed no duty to defend Defendant pay any judgments obtained against Defendant in the underlying action. Plaintiff further sought a declaration as to the deductible owed by Defendant pursuant to the policy. Defendant brought counterclaims against Plaintiff for breach of contract, breach of the implied covenant of good faith and fair dealing (for both contract and tort damages), as well as a violation of NRS § 686A.310(1)(a). Defendant further sought a declaration that the subject policies covered construction defect claims, that Defendant was entitled to indemnification under the policies, that the policies were enforceable, that Plaintiff had a duty to defend Defendant, and that Defendant was entitled to costs and fees regarding the instant action. Plaintiff moved to dismiss Defendant's counterclaims.

The Court granted Plaintiff's motion with respect to the alleged breach of contract and breach of the implied covenant of good faith and fair dealing for both contract and tort damages. Defendant alleged in its counterclaim that Plaintiff failed to acknowledge its obligations under the policies, reserved its rights under the policies, and brought the instant declaratory judgment action. The Court held, however, that merely reserving rights and seeking declaratory judgment as to obligations under a policy do not constitute a breach. In reaching this decision, the Court noted that Plaintiff had been continued to defend Defendant with respect to the underlying action while reserving its rights and seeking declaratory

judgment. So long as Plaintiff defended Defendant, its actions constituted a breach of contract or an act of bad faith.

The Court also granted Plaintiffs motion to dismiss as to the alleged violation of NRS § 686A.310(1)(a). In reaching its decision, the Court noted that this statute concerned an insurer's misrepresentation of material facts with respect to the handling of a claim as opposed to whether the claim was denied or not. Defendant argued that the underlying policies issued by Plaintiff contained vague and misleading exclusions, and that Plaintiff relied on the exclusions to deny coverage. The counterclaim was dismissed because Defendant failed to allege any facts that could support a misrepresentation by Plaintiff, as opposed to Defendant's failure to read the underlying exclusions.

Finally, with respect to Defendant's request for declaratory relief as to the underlying policies, the Court denied Plaintiff's motion to dismiss. Plaintiff argued in its motion that Defendant's request for declaratory judgment was duplicative both of Defendant's counterclaims as well as Plaintiff's declaratory judgment claims. The Court denied Plaintiffs motion and held that Defendant's requests for declaratory judgment was appropriate and not duplicative. The Court found the request appropriate because, as required by common law, they would clarify and settle legal claims at issue while also eliminate legal controversy. The Court also found that Defendant's request was not duplicative to its counterclaims because the request addressed the parties' obligations going on a going forward basis. The counterclaims, on the other hand, addressed the parties' prior conduct.

Practice Note: The dismissal of Defendant's counterclaims was heavily premised upon the fact that Plaintiff had been continually defending Defendant throughout the underlying action and instant action for declaratory judgment. Plaintiff's initial agreement to defend, subject to its reservation of rights, allowed it to pursue a declaration of its rights and obligations under the policy free from liability.

North Carolina

Applying A Multiple Trigger Of Coverage Test Where Of Property Damage Is Uncertain

Harleysville Mut. Ins. Co. v. Hartford Cas. Ins. Co., 2015 U.S. Dist. LEXIS 25362 (E.D. N.C. Feb. 26, 2015)

This matter concerns a declaratory judgment action stemming from general commercial liability coverage for claims against a roofing contractor. The court handled complex issues where the alleged accidents caused the injuries-in-fact on dates that were not certain.

The plaintiff, Harleysville Mutual Insurance Company, sought entry of a declaratory judgment action regarding the relative rights of the parties under policies of commercial general liability insurance issued by Harleysville; Hartford Casualty Insurance Company and Hartford Fire Insurance Company; Assurance Company of America, First Financial Insurance Company, and First Mercury Insurance Company to defendant G.R. Hammonds, Inc. Harleysville sought a judgment declaring and adjudging whether and to what extent coverage is afforded under the respective policies of the insurance companies as a result of claims asserted against Hammonds in three sets of underlying state court lawsuits. The claims asserted against Hammonds at three multi-family residential construction projects.

Hammond is a business in the construction industry that installs roofs on buildings. It was insured under commercial general liability policies issued by Hartford, assurance, First Financial, Harleysville, and First Mercury for different time periods. In general, the plaintiffs in the underlying lawsuits — plaintiffs concerning the three residential construction projects — alleged that they sustained water damage because of poor workmanship on each building's roof. The dates the water damages happened were uncertain.

The district court analyzed and discussed several cases determining trigger of coverage for identical insurance policy provisions. The court primarily relied on *Gatson County Dyeing Mach. Co. v. Northfield Insurance Co.*, 351 N.C. 293, 524 S.E.2d 558 (2000). In *Gatson*, a manufacturing company brought a declaratory judgment action to determine coverage under its insurance policies with three separate insurers, arising out of an underlying products liability lawsuit brought by a pharmaceutical company against Gatson. In the underlying lawsuit, the pharmaceutical company alleged that Gatson defectively designed and manufactured a pressure vessel that was used in production of contrast media dyes by the pharmaceutical company for diagnostic medical imaging. The pharmaceutical company alleged that, on July 21, 1992, it increased the operating

pressure in the vessel, and chemical used in connection with the production process began leaking into the vessel. Ultimately, the leaking chemical contaminated over 60 tons of contrast media dye produced over a period of time until the leak was discovered on August 31, 1992.

The period of leaking spanned different insurance policy periods. The North Carolina Supreme Court affirmed the trial court's determination that the "occurrence" of "property damage" took place on June 21, 1992, when the pressure vessel ruptured and the leak first started. The court looked to the "date of the injury-in-fact" as opposed to the date of the defect in the installed product to determine the trigger of coverage under the same commercial general liability policy.

In light of the *Gatson* holding, the district court in this case concluded that the injury in these cases was when the resulting deterioration of the walls and interior structures occurred. The district court concluded that the language of the policies in the matter at hand and North Carolina law does not support using the date of the completion of defective construction as the trigger date for coverage under the policies. The district court also concluded that the coverage was triggered under all policies in effect during the time between the date construction was completed on any building and the date of the lawsuits. It reasoned that "the start date of the 'occurrence' or 'accident' in the underlying lawsuits is inherently uncertain and [the accident] could have taken place at any time between the date construction was completed on any building and the date of the lawsuits. The district also concluded that no exclusions to such coverage applied.

Practice Note: In the context of a multiple triggers of coverage test and where North Carolina law applies, practitioners should look to the reasoning in *Gatson County Dyeing Mach. Co. v. Northfield Insurance Co.*, 351 N.C. 293, 524 S.E.2d 558 (2000). The district court rejected several other decisions addressing the same issue, relying heavily on *Gatson* for its determination.

Oregon

Duty To Defend

Seneca Insurance Company v. James River Insurance Company, 2014 U.S. Dist. LEXIS 97156 (D. Or. July 16, 2014)

In this action, Seneca Insurance Company (Seneca) sought a declaratory judgment against defendant, claiming that defendant had a duty to defend Seneca's insured in an underlying construction defect action and sought 50% of the defense cost Seneca incurred in defending the insured and one of its principals in the underlying action. Defendant filed a motion for summary judgment. The Court noted that an insurer's duty to defend depends on the complaint and the insurance policy. If the complaint provides any basis for coverage, the duty to defend arises. In Oregon, the complaint does not need to allege the specific time when a covered experience occurred, as that issue is one to be determined at litigation and may affect the duty to indemnify, but not the duty to defend.

The Court held that the complaint in the underlying action triggered the duty to defend obligations of the defendant and that duty commenced upon the filing of the underlying action. The Court rejected defendant's attempt to use vague date references in the underlying complaint in an effort to establish that those dates established that the property damage occurred before the effective date of the policy.

Practice Note: Unlike other jurisdictions which may allow for documents outside the complaint in determining whether a duty to defend occurs, the Court noted that in Oregon the only two documents that can be considered are the insurance policy and the complaint in the underlying action.

Texas

Contractual Liability, J(5) and J(6) Exclusions

Crownover v. Mid Continent Cas. Co., 772 F.3d 197 (5th Cir. 2014)

Plaintiff commenced suit against defendant seeking recovery of an arbitration award obtained against defendant's insured for defective work on a home. Both parties moved for summary judgment. At the crux of the motions was whether a contractual provision in the construction contract that obligated defendant's insured to repair its work was an "assumption of liability" that exceeded the insurer's liability under Texas law, thereby triggering a "contractual-liability exclusion" in defendant's insurance policy. Additionally, if the contractual-liability exclusion did not apply,

defendant argued that other coverage exclusions in the policy applied.

The Court found that the insured's express duty to repair did not expand its obligations that were not already covered by general law and, as a result, the contractual liability exclusion for coverage did not apply.

Defendant alternatively argued that if the contractual-liability exclusion did not apply, the "your work" exclusion and exclusions j(5) and j(6) applied. The relevant policies had been issued in 2001 through 2002 and 2002 through 2003. The "your work" exclusion provision had an exception for work performed by a subcontractor but that exception was removed in August 2003. Defendant argued that the plaintiff's foundation did not move "excessively" until after the exception had been removed and therefore the "your work" exclusion applied. The Court held that the evidence revealed that the damage first occurred before the exception was removed and thus the exclusion did not prevent coverage.

In regard to exclusions j(5) and j (6), the Court held that the evidence revealed that the home was initially satisfactory when the plaintiffs moved into the home and that the first cracks appeared after they had moved in, which was after the work had been completed. As a result, the Court found that the j(5) and j(6) provisions did not prevent indemnity. As a result, the Court reversed the District Court's grant of summary judgment for defendant and granted summary judgment to plaintiff.

Practice Note: In examining whether the contractual-liability exclusion applied, the Court noted that even if the insured was found to have breached a contractual duty, the Court can still explore whether the breach of the express duty to repair represented an actual expansion of liability beyond that provided by general law.

Utah

Chapter 40 Proceedings Under Colorado Law

Cincinnati Ins. Co. v. AMSCO Windows, 593 Fed. Appx. 802 (10th Cir. 2014)

The insured manufactured windows for use in homes and sells its products to wholesale distributors and

dealers, but did not install its own products or hire contractors. The homeowners asserted claims against the manufacturers under "Chapter 40" which is a Nevada statute governing homeowner construction defect claims that requires a claimant to give written notice to contractors before it can proceed into civil litigation. The court held that the allegations in the underlying action triggered the insurer's duty to defend because the faulty workmanship involving the insured's windows caused property damage to something other than the insured's work product. The court, however, held that the Chapter 40 Proceeding did not constitute a "suit" under the policy because the proceedings was an "informal" process to resolve construction defect claims by homeowners.

Practice Note: The State of Colorado has an interesting procedural process that predates the resolution of construction defect claims.

Washington

"Constitution Bar "Insured Against Non-Settling Insurer."

Canal Indem. Co. v. Global Dev., LLC, 2015 U.S. Dist. LEXIS 8774 (W.D. Wash., Jan. 23, 2015)

Insurance coverage actions brought by Canal Indem. Co. ("Canal") and Arch Specialty Insurance Co. ("Arch") were joined. In these actions Canal and Arch sought a declaration with respect to their coverage obligations for claims asserted against their named insured Global Dev. LLC ("Global") relating to alleged construction defects in various properties developed by Global for the property owners. The property owners settled with Canal and four excess insurers and in this action were seeking the entry of a "Constitution Bar" in order to prevent Arch, as the non-settling insurer, from pursuing construction claims against the settling insurers. The court, in reviewing the history and importance of a contribution bar, granted such a bar which precluded subsequent claims for contribution and by non-settling parties, so long as the non-settling parties receive notice and have their rights protected. In doing so, the court held that the settlement was reasonable and the interests of the non-settling defendants were protected.

Practice Note: The court noted that the contribution bar can be essential to multi-party litigation and is

consistent with the public policy in Washington of encouraging settlement. Also, the court reviews the criteria utilized in assessing such requests.

Liability

California

Default — Insurer Entitled To Judgment

Atain Specialty Ins. Co. v. North Bay Waterproofing, Inc., 2015 U.S. Dist. LEXIS 11404 (N.D. Ca. Jan. 30, 2015)

Atain Specialty Inc. Co. (“Atain”) filed the instant action against its insured North Bay Waterproofing, Inc. (“North Bay”) and an additional insured under its policy Douglas Ross Construction, Inc. (“DRC”) and alleged that Atain did not have an obligation to defend or indemnify North Bay and DRC. DRC, as general contractor, had been sued in an underlying action by owners of a residential apartment complex for damages as a result of defective design or construction of the apartment project. DRC cross-claimed against North Bay as a subcontractor alleging breach of contract, duty to defend, duty to indemnify and duty to obtain insurance. Further, DRC tendered its defense of the underlying action and North Bay’s defense of the cross-complaint to Atain. As a result of the tender, Atain disclaimed coverage based on its position that there was no possibility of coverage because the underlying claims did not fall within the scope of the insuring argument and several policy exclusions eliminated coverage. At issue on this case was Atain’s motion for a default judgment because neither DRC nor North Bay filed a response to Atain’s complaint. The Court after weighed the following seven factors in granting Atain’s motion:

1. The substantive merits of the plaintiff’s claim;
2. The sufficiency of the complaint;
3. The amount of money at stake in relation to the seriousness of defendant’s conduct;
4. The possibility of prejudice to plaintiff if relief is denied;
5. The possibility of dispute as to any material facts in the case;
6. Whether default resulted from excusable neglect; and
7. The strong policy of the Federal Rules of Civil Procedure favoring decisions on the merits.

From a coverage perspective, the court noted that the underlying claim fell outside the scope of the Insuring Agreement and coverage is precluded by the “Total Residential” coverage exclusion. These two factors plus its assessment of the other factors weighed heavily in favor of the entry of a default; therefore, the court granted Atain’s default judgment.

Practice Note: The court reviews the historical perspective of *Montrose* when contrasted with anti-Montrose policy language which is acceptable and precludes coverage for “continuous injury” in California.

California

Abstention Doctrine — Abstention Denied

Fid. and Guar. Ins. Co. v. Centex Homes, 2014 U.S. Dist. LEXIS 41716 (C.D. Cal. Mar. 26, 2014)

Plaintiff commenced a declaratory action against its additional insured. The action stemmed from several underlying construction defect lawsuits brought by various homeowners against defendant for alleged defective construction of homes. Defendant had tendered its defense and indemnification to plaintiff as an additional insured under policies issued various subcontractors. Plaintiff accepted defendant’s tender with the reservation of rights and assigned counsel of its choice to defend defendant. Defendant objected to plaintiff’s appointed counsel unless they acknowledged a conflict of interest and agreed to pay defendant’s independent counsel.

Defendant filed a motion to dismiss or, alternatively, to stay the declaratory judgment action. The Court refused to exercise its discretion and apply the abstention doctrine. Additionally, the Court found that a stay of the declaratory judgment proceedings would prejudice the plaintiff and make the relief sought moot and therefore refused to issue a stay.

Practice Note: The Court analyzed the applicability of the abstention doctrine and analyzed cases from other jurisdictions where the abstention doctrine had been applied.

California

Staying Of Federal Court Action

Delwebs Coventry Homes Inc. v. National Union Fire Insurance Company, 2014 U.S. Dist. LEXIS 180949 (C.D. Cal. May 29, 2014)

Plaintiff, a general contractor, sought recovery as an additional insured under insurance policies issued by defendants to plaintiff's subcontractors in connection with a construction defect litigation brought in state court. Various defendants had commenced a third-party action against plaintiff's excess carrier. The issue in the third-party action was also being litigated in a state court action filed almost two years prior to the third-party action. The third-party defendant filed a motion to dismiss or stay the third-party complaint in light of the state court action.

The Court denied the motion to dismiss, as it noted that dismissal was disfavored and the preferred method would be a stay pending resolution of the state action. The Court issued a stay of the third-party complaint.

Practice Note: In analyzing the following factors: (1) avoiding needless determination of state law issues; (2) discouraging form shopping; and (3) avoiding duplicative litigation, the Court seemed to be swayed in favor of staying the third-party action because the state court action had been ongoing for almost two years and was further along in the litigation.

California

Arbitration Award Upheld And Confirmed

Braunhagey & Borden LLP v. GNP Haw., Inc., 2014 U.S. Dist. LEXIS 22504 (N.D. Cal. Jan. 27, 2014)

Plaintiff, a litigation law firm, filed a petition to confirm an arbitration award it had obtained against defendants. Plaintiff had been retained to represent the defendants in a construction defect action and in a coverage dispute action. After successfully defending the defendant in both actions, defendant failed to pay plaintiff's legal fees. Pursuant to its retainer agreements with defendants, plaintiff filed the fee dispute through arbitration and obtained an award. Defendant did not appear to argue against confirmation of the arbitration award. The Court confirmed the arbitration award. This decision was the recommendation of the assigned Magistrate Judge, which was subsequently adopted by the district judge in *Braunhagey & Borden LLP v. GNP Haw., Inc.*, 2014 U.S. Dist. LEXIS 22501 (N.D. Cal., Feb. 20, 2014).

Practice Note: The Court's decision makes clear that California favors arbitration of disputes and that an arbitration award is not to be disturbed in the absence of substantial factors questioning the integrity of the process such as corruption, fraud, or undue means, none of which were present in this case.

California

Proposed Jury Instruction — Exclusions J(5) & (6)

ProBuilders Specialty Ins. Co. v. Valley Corp. B., 2014 U.S. Dist. LEXIS 165926 (N.D. Cal., Nov. 26, 2014)

In the underlying action, the insured was sued by the owners for substandard and incomplete work in the construction of their home and the court awarded the homeowners a judgment in the sum of nearly \$2.0 million. The insurer made a motion for a new trial and the court denied the motion holding that: 1. The jury verdict was not against the weight of the evidence; 2. There was not any confusing and prejudicial evidence offered at trial; 3. Nor was any improper jury instruction given with respect to the exclusions contained in the relevant policy.

Practice Note: The court's analysis of the proper jury discussion relative to 4 exclusions, including exclusions J(5) and (6) is extremely informative.

Nevada

Abstention Doctrine — Abstention Granted

Certain Underwriters at Lloyd's, London v. Palm Canyon Dev., Inc., 2014 U.S. Dist. LEXIS 55779 (D. Nev. Apr. 22, 2014)

This case concerns coverage for an underlying lawsuit against the defendant for alleged defective construction. Defendant's insurance carrier filed a declaratory judgment action seeking a declaration that it was not liable under the policy because the alleged damages to the property fell within the policy's exclusions. The plaintiff filed a motion requesting that the district court abstain and decline to exercise jurisdiction over the case in light of a pending state court action. The Court found that abstention was warranted and granted defendant's motion. The Court held that the case raised legal questions that rely on the same factual scenario

being litigated in the state court action, thereby requiring abstention. The Court also noted that the state law provided a vehicle by which plaintiff could pursue declaratory relief in state court.

Practice Note: Nevada courts appear to be willing to exercise its discretion in abstention, as the same court granted a similar motion in *Century Sur. Co. v. D&J Family Trust*, 2014 U.S. Dist. LEXIS 134716 (D. Nev. Apr. 18, 2014).

Nevada

Personal Jurisdiction — Specific Versus General Jurisdiction

Evanston Insurance Company v. Western Community Insurance Company, 13 F.Supp.3d 1064 (D. Nev. 2014)

In this coverage dispute, the Court dealt with defendant's motion to dismiss for lack of personal jurisdiction. Western Community Insurance Company ("Western") did not conduct any business in Nevada, was not licensed in Nevada, and the subject policy was negotiated and issued outside of Nevada. The Court determined that although it could not exert general jurisdiction over the Western, it could exert specific personal jurisdiction over it. The Court held that the policy's "coverage territory" included the United States of America and was not limited to Western's home state of Idaho. Thus, Western had purposely availed itself to the benefits of conducting business in Nevada and therefore was subject to specific jurisdiction. The court also held that Western failed to carry its burden of presenting a compelling reason that the exercise in jurisdiction would not be reasonable. As jurisdiction over Western was proper, it denied the portion of defendant's motion alleging improper venue.

Practice Note: The Court's decision provides a good analysis of the requirements for personal jurisdiction over an out-of-state defendant.

Washington

The Breadth Of Discovery Regarding Settled Claims

Milgard Mfg., Inc. v. Liberty Mut. Ins. Co., 2015 U.S. Dist. LEXIS 12761 (W.D. Wash. Feb. 3, 2015)

Plaintiff Milgard Manufacturing, Inc. obtained a general liability policy from Illinois Union Insurance Company. This policy had a term of December 31, 2001 to December 31, 2002, and a self-insured retention limit of \$50,000 per claim. Milgard also obtained an excess liability policy from Liberty for the same policy period.

Between 2012 and 2013, Milgard tendered numerous construction defect claims to Liberty. In September 2013, Milgard informed Liberty that nine of these tendered claims had settle or were expected to settle within the SIR, and thus no further action was needed from Liberty at that time.

In November 2013, Milgard filed suit against Liberty in state court. Liberty removed the matter to federal court. Milgard alleged that Liberty (1) failed to meet its obligations under the excess liability policy, (2) acted in bad faith in handling tendered claims, and (3) violated Washington laws and regulations.

Later that month, Milgard served Liberty with notice of a Rule 30(b)(6) deposition. Milgard's deposition topics related to all tendered claims, including the nine that settled. Thereafter, the parties held a Rule 26(c)(1) discovery conference. That same day, Liberty filed a motion for a protective order. In response, Liberty sought a protective order to preclude Milgard from seeking testimony or conducting discovery into nine claims that settled. Liberty argued that any discovery into the claims is irrelevant because Liberty does not have a duty to defend or indemnify withdrawn claims.

The district court found that Liberty failed to show good cause for a protective order. Rejecting Liberty's argument that the nine claims are irrelevant, the district court reasoned that those nine claims prior to settlement are still relevant to Milgard's bad faith action because the information appears to be either admissible or reasonably calculated to lead to the discovery of admissible evidence. The district court cited to *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 165 Wn.2d 122, 196 P.3d 664 (2008) and quoted the following language from that decision: "In the third-party context, an insurer can act in bad faith even where coverage is later determined to be unavailable." As such, the district court denied Liberty's motion.

Practice Note: It is an abuse of discretion standard that applies to a trial court's decision to issue a protective order. The movant should not make conclusory statements in support of the motion. A

unfavorable absence of substantial factors questioning the integrity of the process such corruption, fraud, or undue means, none of which were present in this case. ■

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