Opinion

SDV's Picks:
The Top 10 Insurance Coverage Decisions of 2015

1. *Capital City Real Estate LLC v. Certain Underwriters at Lloyd's, London* - U.S. Court of Appeals for Fourth Circuit, June 10, 2015 788 F.3d 375 (4th Cir. 2015)

Importance of Case: The case addresses a common issue presented by additional insured claims – whether extrinsic evidence can be utilized to determine an insurer's duty to defend as opposed to simply the allegations contained in the "four corners" of the complaint. The Fourth Circuit decided to allow extrinsic evidence in evaluating an insurer's duty to defend.

Facts: Capital City Real Estate LLC was acting as the general contractor for the renovation of a property located in Washington, D.C. Capital City subcontracted the foundation, structural and underpinning work to Marquez Brick Work, Inc., requiring Marquez to obtain CGL insurance naming Capital City as an AI and to indemnify Capital City for damages caused by its work. Marquez obtained a CGL policy from Certain Underwriters at Lloyd's, London with an endorsement listing Capital City as an AI. The AI endorsement covered Capital City for its liability for property damage caused in whole or in part by Marquez's acts or omissions.

During the course of Marquez's work on the project, a common wall shared by the adjacent property owner collapsed. The insurer for the adjacent owner sued Capital City for the damage to the wall. The underlying complaint against Capital City failed to mention the named insured, Marquez. Capital City filed a DJ action against Underwriters in Maryland federal district court, seeking a declaration that Underwriters was required to defend it as an AI in the underlying suit. The district court ruled in favor of Underwriters, finding no defense was owed because the complaint was silent as to the involvement of Marquez. Capital City appealed.

Holding: The Fourth Circuit, applying Maryland law, held that extrinsic evidence is allowed to establish that the damage was caused by Marquez, the named insured, entitling Capital City to a defense, even though the complaint only identifies Capital City as causing the damage.

For more information on this issue, see SDV's Extrinsic Evidence 50 State Survey, available here: http://www.sdvlaw.com/wp-content/uploads/2015/11/Extrinsic-Evidence-State-by-State-Survey.pdf

2. *Structure Tone, Inc. v. National Cas. Co.* - Supreme Court of New York, Appellate Division, First Department, July 2, 2015 13 N.Y.S.3d 52 (N.Y. App. Div. 2015)

Importance of Case: On a wrap-up project, a general contractor was denied AI coverage by the insurer of an unenrolled subcontractor due to a commonly used wrap exclusion on its policy.

Facts: Kleinknecht Electric Company, Inc. entered into a subcontract with Structure Tone, Inc. to perform electrical work on a project. The subcontract required Kleinknecht to maintain liability insurance and to name Structure Tone as an AI. Kleinknecht procured a policy from National Casualty Company. Thereafter, Structure Tone sought coverage as an AI on the Kleinknecht Policy in connection with a personal injury suit against Structure Tone that arose out of Kleinknecht's work. National Casualty denied Structure Tone's claim in reliance upon the Kleinknecht Policy's exclusion entitled "Exclusion-Designated Operations Covered by A Consolidated (Wrap-Up) Insurance Program" which provides: "This insurance does not apply to 'bodily injury' … arising out of either your ongoing operations or operations included within the 'products-completed operations hazard' at the location described in the schedule of this endorsement, ***as a consolidated (wrap-up) insurance program has been provided by the prime contractor/ project manager or owner of the construction project in which you are involved."*** (emphasis added.)

Holding: The First Department held that the wrap-up exclusion quoted above barred AI coverage for the wrap-up project's general contractor, even though the subcontractor was not enrolled in the wrap-up.

3. *U.S. Metals Inc. v. Liberty Mutual Group, Inc.* - Texas Supreme Court, December 4, 2015 59 Tex. Sup. Ct. J. 144 (Tex. 2015)

Importance of Case: The Texas Supreme Court joined a majority of state supreme courts by rejecting the "incorporation theory," finding that the installation of defective components into a larger system does not constitute "physical injury" under a CGL policy. However, in a win for policyholders, the court found certain "rip and tear" damages were covered.

Facts: U.S. Metals sold 350 custom flanges to ExxonMobil for use in its refineries in Texas and Louisiana. It became apparent that the flanges did not meet industry standards, requiring their removal from the refinery units and replacement to prevent the risk of fire and explosion. The replacement process required stripping the insulation, cutting each flange out of its respective pipe and replacing, rewelding, and reinsulating the new flanges. The process delayed operation at both refineries for several weeks. Exxon sued

U.S. Metals for approximately $6.3 million for the costs of replacing the flanges and an additional $16.3 million in damages for loss of use. The parties settled for $2.2 million, and U.S. Metals sought indemnification from its CGL carrier, Liberty Mutual.

Liberty Mutual denied coverage in reliance on the "your property" and "impaired property" exclusions under the CGL policy. The dispute concerned whether the installation of the faulty flanges physically injured Exxon's property when the only harm at that point was risk of leakage and further, whether property is restored to use by replacing a faulty component when the property must be altered, damaged, and repaired in the process.

Holding: U.S. Metals was not entitled to indemnity for the cost to remove and replace the faulty parts. In so holding, the court addressed and answered the following two questions:

> 1) Is property physically injured simply by the incorporation of a faulty component with no tangible manifestation of injury? No. The Texas Supreme Court rejected the incorporation theory, finding that physical injury requires tangible, manifest harm and does not result merely upon the installation of a defective component into a product or system.
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> 2) Is property restored to use by replacing a faulty component when the property must be altered, damage, and repaired in the process? Yes, and therefore, the property (in this case, the diesel units on which the flanges were welded) is considered "impaired property" to which the exclusion applies. Within its analysis, however, the court did find that the "impaired property" exclusion did not apply to the insulation and gaskets which had been destroyed in the repair process because they had to be replaced and were not restored to use. Thus, the cost of replacing the insulation and gaskets (i.e., "rip and tear" or "get to" damages) was covered by the policy.

4. *In re: Deepwater Horizon* - Supreme Court of Texas, February 13, 2015 470 S.W.3d 452 (Tex. 2015)

Importance of Case: A CGL policy's AI endorsement, which incorporated certain language from an underlying trade contract, limited the scope of AI coverage afforded.

Facts: In 2010, the Deepwater Horizon oil-drilling rig exploded and sank, discharging below the surface of the Gulf of Mexico the largest oil spill in history. Transocean, which owned the Deepwater Horizon, was a party to a drilling contract with BP, the oil field developer, wherein Transocean assumed full responsibility for above-surface oil pollution discharges without regard to the negligence of any party, and BP assumed full responsibility for any pollution or contamination without regard to the negligence of any party which was not assumed by Transocean. The contract required that Transocean procure insurance to support the indemnity obligation, and to name BP as an AI on its primary and excess insurance policies. BP sought coverage for the catastrophe as an AI on policies procured by Transocean.

Holding: BP's rights as an AI were not governed solely by the broad scope of the insurance policy, but instead, the policy specifically incorporated the contractual limitations of the drilling contractor's indemnity obligations which did not include liabilities for underwater pollution. As a result, the court denied BP's claim for AI coverage for the spill, concluding: (1) Transocean's policy language incorporated by reference the drilling contract entered into by BP and Transocean, and (2) the drilling contact contained language that limited BP's AI status to only those liabilities Transocean assumed under the drilling contract.

5. *Recall Total Info. Mgmt. v. Fed. Ins. Co.* - Connecticut Supreme Court, May 26, 2015 317 Conn. 46 (Conn. 2015)

Importance of Case: The Connecticut Supreme Court denied CGL coverage for data breach because the loss of computer tapes from the back of a truck, exposing personal employee information, was not considered a "publication" as required by the policy.

Facts: The facts of this case make it unique in that they are not what one would envision as a data breach. A cart containing old computer tapes fell out of the back of a transportation vendor's van. An unknown individual retrieved 130 of these tapes, which contained the names, birth dates, addresses, and social security numbers of about 500,000 present and former IBM employees. There was no evidence, however, that the information on the tapes was ever accessed.

Holding: A CGL insurer was not required to defend or indemnify its insured for damages stemming from the loss of computer tapes; even though there was evidence the tapes fell into the hands of an unknown third party, there had been no "publication" because there was no evidence of access. In order to constitute a publication, the information needed to be disseminated and there was no evidence of such dissemination.

6. *Kelly v. State Farm Fire & Casualty Co.* - Supreme Court of Louisiana, May 5, 2015 169 So. 3d 328 (La. 2015)

Importance of Case: Under Louisiana's bad faith statute, a CGL insurer was liable for bad faith failure to settle even without receiving a firm settlement offer.

Facts: Danny Kelly was injured in a car accident with Henry Thomas. Thomas had liability insurance with State Farm. Thomas's fault was disputed. Kelly rejected State Farm's settlement offer for the amount of the policy limits ($25,000) and filed suit against Thomas. The suit proceeded to trial; Thomas was found liable and judgement entered for approximately $176,000. In exchange for an agreement not to pursue him personally, Thomas assigned to Kelly his right to pursue a bad-faith action against State Farm.

Holding: A CGL insurer can be found liable to the insured for a bad-faith failure-to-settle claim even if the insurer never received a firm settlement offer. An insurer's duties to make reasonable efforts to settle can be triggered by information other than the mere fact that a third party has made a settlement offer. The court pointed to the governing statute's language that an "insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both."

7. *Mellin v. Northern Security Insurance* - Supreme Court of New Hampshire, April 24, 2015 115 A.3d 799 (N.H. 2015)

Importance of Case: Odor alone qualifies as "physical loss" under a first party property policy under New Hampshire law.

Facts: Plaintiffs owned a condominium unit which they rented to tenants. A cat odor, emanating from a neighbor's unit, forced the tenants to move out. Subsequently, the plaintiff owners moved in, also noticed the odor, and filed a claim under their homeowner's policy which was denied. While the details of the initial claim are not apparent from the decision, the plaintiffs later claimed that the odor prevented them from having tenants. The unit was inspected and plaintiffs were advised that the odor presented a health problem and they should temporarily vacate and remediate the premises. Remediation was not successful and plaintiffs eventually sold the unit. They asserted that the sale price of the unit was significantly less than a comparable unit unaffected by odor. Plaintiffs brought suit against Northern Security, seeking a declaration that they were entitled to coverage because they sustained a "direct physical loss." The trial court found that the plaintiffs did not suffer a "physical loss" and the plaintiffs appealed.

Holding: The odor constituted a "physical loss." "Physical loss" can encompass "distinct and demonstrable" changes perceived by the sense of smell which can exist in the absence of structural damage. Demonstration of a "tangible physical alteration" is not required.

8. *Atl. Cas. Ins. Co. v. Greytak* - Supreme Court of Montana, May 29, 2015 350 P.3d 63 (Mont. 2015)

Importance of Case: Montana joined the majority of jurisdictions in following the "notice-prejudice" rule.

Facts: GTL, a construction company insured by Atlantic Casualty Insurance Company, filed suit against Greytak for non-payment of contract amounts due in connection with a construction project. Greytak responded by filing a counterclaim for construction defects. An agreement was reached between GTL and Greytak months later, whereby GTL was to notify Atlantic of Greytak's counterclaims; and if Atlantic did not appear in the case to defend or file a declaratory action, GTL would permit a $624,685 judgment in favor of Greytak to be entered. GTL first notified Atlantic of Greytak's counterclaims after the settlement agreement and over one year after the assertion of the counterclaims by Greytak. Atlantic sued GTL and Greytak in the United States District Court for the District of Montana, seeking a declaration that it was not required to defend GTL from Greytak's counterclaims or pay the judgment.

Holding: An insurer cannot avoid its obligation to defend and indemnify its insured simply due to a failure to receive timely notice without demonstrating that it suffered some prejudice as a result.

9. *McGinnes Indus. Maintenance Corp. v. The Phoenix Ins. Co.* - Supreme Court of Texas, June 26, 2015 58 Tex. Sup. Ct. J. 1439 (Tex. 2015)

Importance of Case: In a win for policyholders, the Texas Supreme Court held that a PRP letter constituted a "suit," joining the majority of other state supreme courts to consider the issue. The decision will likely have broader implications for governmental demands of other types.

Facts: McGinnes Industrial Waste Corporation dumped waste into disposal pits near the San Jacinto River in Texas in the 1960's. In 2005, the EPA began investigating the site for potential environmental contamination and a few years later sent letters to McGinnes' parent company and McGinnes stating that they were PRPs (potentially responsible parties). The EPA sent a subsequent letter only to McGinnes stating that it determined that McGinnes was responsible for cleaning up the site and demanding approximately $378,000.00 in cleanup costs and requiring that McGinnes make a good faith effort to settle within 60 days.

McGinnes requested a defense from its two CGL insurers at the time of the disposal, Phoenix and Travelers. The insurers refused coverage on the grounds that the proceedings did not constitute a "suit" under the policies, which provided: "[T]he company shall have the right and duty to defend any suit against insured seeking damages on account of such . . . property damage, . . . and may make such investigation and settlement of any claim or suit it deems expedient . . . ."

McGinnes sued the insurers in federal district court, seeking a declaration that they were obligated to defend the EPA's CERCLA proceedings.

Holding: A potentially responsible party letter from the EPA constituted a suit McGinnes' CGL policy, triggering the insurer's duty to defend. The court reasoned that CERCLA authorizes the EPA to conduct on its own what would otherwise amount to pretrial proceedings. Also, the EPA proceedings sought covered damages under the policies.

10. *Travelers Indemnity Co. v. Centex Homes* - United States District Court for the Northern District of California, October 7, 2015 - 2015 U.S. Dist. LEXIS 137898 (N.D. Cal. 2015)

Importance of Case: A CGL insurer lost its right to control the defense of a suit when it failed to provide a defense after its duty to defend was triggered. It is expected that this decision will help ensure a speedy response to claims by insurers, or, in the alternative, continuity of defense counsel should the insurer delay in responding to a tender.

Facts: Centex, a real estate developer, hired subcontractors to build residential homes. Each subcontractor hired by Centex procured CGL insurance from Travelers which named Centex as an AI. A number of construction defect suits were filed against Centex, and Centex tendered each action to Travelers. In the meantime, Centex hired its own defense counsel to protect its interests. After some delay, Travelers finally agreed to defend Centex and sought to appoint its desired counsel. Centex argued that Travelers lost its right to control the defense and insisted on retaining its originally appointed defense counsel.

Holding: A CGL insurer loses its right to control the defense of its insured if it fails to provide the insured with a defense immediately

after its duty to defend is triggered. In failing to provide Centex with a defense within 30 days after the complaints were filed in the underlying actions, Travelers breached its duty to defend, and as a result, lost its ability to control the defense.

Cases to Watch in 2016

***Cypress Point Condominium Association, Inc. v. Adria Towers, LLC,* case number 076348, in the New Jersey Supreme Court**

In July of 2015, a New Jersey appellate level court held that unintended and unexpected consequential damages caused by subcontractors' defective workmanship constitutes "property damage" and an "occurrence" under a CGL policy. Cypress Point Condo. Ass'n, Inc. v. Adria Towers, L.L.C., 118 A.3d 1080 (Super. Ct. App. Div. 2015), cert. granted, 124 A.3d 240 (N.J. 2015).

A condominium association brought suit seeking coverage from the general contractor's insurer for damages caused by the defective work of subcontractors who were contracted to perform all of the construction work on the project. The subcontractors failed to properly install the roof, flashing, gutters and leaders, brick and façade, windows, doors and sealants, which caused consequential damages to the common areas and unit owners' property. The court reasoned that there had clearly been "physical injury to tangible property," constituting "property damage." Further, the consequential damages amounted to "continuous or repeated exposure to substantially the same general harmful conditions" for which it cannot reasonably be believed that the subcontractors intended to cause, satisfying an "occurrence."

In so holding, the court declined to follow prior New Jersey case law finding that construction defects did not constitute "occurrences," differentiating those decisions on the basis that they interpreted earlier versions of the standard form CGL policy. If the New Jersey Supreme Court affirms the Appellate Division, New Jersey would align itself with the majority of state appellate courts, that hold that construction defects causing consequential damages constitute "occurrences."

***FountainCourt Homeowners' Association et al. v. FountainCourt Development LLC et al.,* case number S062691, in the Oregon Supreme Court**

In 2015, the Oregon Supreme Court granted certification on several questions, including: "If a general verdict is returned against an insured entity in a mixed coverage case (i.e., one involving both covered and uncovered damages), and the insurer defended under a reservation of rights, can the insured establish coverage for the awarded damages based on the general verdict?" FountainCourt Homeowners Ass'n v. FountainCourt Dev., LLC, 346 P.3d 1212 (Or. 2015) (order granting petition for review).

In the underlying suit, judgment was entered against the policyholder, a siding company, for damages due to construction defects at a housing development. The plaintiff in the underlying suit then sought a writ of garnishment against American Family Mutual Insurance Co. for the amount of the judgment entered against its policyholder. American Family's position is that they should not be on the hook for the full amount of the judgment as the damages award was unallocated and only a portion of the judgment is covered by the policy. The plaintiff contends that American Family is attempting to revisit issues previously litigated relating to liability, and should be collaterally estopped. A decision is expected in 2016.

***Sebo v. Am. Home Assur. Co.*, case no. 2d11-4063, in the Florida Supreme Court**

In September of 2015, the Florida Supreme Court heard oral argument in Sebo and is expected to release a written opinion in 2016. At issue in this case is coverage under a homeowner's policy for damage caused to a luxury home by rain and a hurricane – a combination of covered and uncovered losses. The court is tasked with deciding whether to apply the concurrent cause doctrine (coverage will be permitted where at least one of the causes is an insured risk) or the efficient proximate cause doctrine (coverage will be permitted only if the more substantial or responsible peril, as determined by the fact finder, is an insured risk).

In 2013, Florida's Second District Court of Appeal rejected the concurrent cause doctrine in Sebo, creating a split of authority in the state. 160 So. 3d 898 (Fla. 2014). Previously, Florida's Third District Court of Appeal had embraced the concurrent cause doctrine. See Wallach v. Rosenberg, 527 So.2d 1386 (Fla. Dist. Ct. App. 1988).

The decision will have enormous implications for the Sunshine State. If the Florida Supreme Court rejects the concurrent cause doctrine, cases will become more expensive to litigate and policyholders will face an uphill battle in establishing coverage.

For more information on any of these decisions, please contact Jeffrey Vita at jjv@sdvlaw.com, Gregory Podolak at gdp@sdvlaw.com, or Grace Hebbel at gvh@sdvlaw.com.