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Creative Coverage Trends in Construction and Beyond

I. DUTY TO DEFEND ISSUES

Duty to Defend "Right to Repair" Proceedings

Most jurisdictions have "right to repair" statutes, which require that a contractor be given notice of the defect, and the ability to repair it before suit can be filed. There is a split in authority over whether these proceedings are covered under a general liability policy. The two main questions addressed by the courts are (1) whether costs incurred in undertaking pre-suit remediation efforts qualify as damages that an insured is "legally obligated to pay" and (2) whether a "right to repair" proceeding qualifies as a "suit". Irrespective, it is often beneficial for an insurer to be involved in this preliminary investigative process.

II. DUTY TO INDEMNIFY ISSUES

Coverage For "Rip and Tear" Costs

Insurers are increasingly having to pay for the repair of non-covered "property damage" where to do so is necessary to repair covered "property damage". This change greatly affects the value of cases for insurers.

For example, without "rip and tear" a carrier before paid for the damaged wood sheathing and personal property damaged by water intrusion resulting from the defective stucco system but was not required to pay for the stuccowork. Now, carriers are being required to not only pay for the damaged property (the wood sheathing and personal property) but also the cost associated with having to replace the work that was "ripped" through to fix the damaged property *e.g.* the external stucco system having to be removed to access and repair those internal framing damages.

Coverage to Repair Ongoing Damage to Prevent Future Damage

An emerging trend is whether coverage can lie for the costs to prevent ongoing damage instead of simply repairing existing damage. Thus far, cases can be read for that proposition. However, there is a split in authority over whether there is coverage for costs incurred solely to prevent future and imminent damage.

Coverage for Warranty, Non-Disclosure and Non-Economic Loss Claims

An emerging issue is whether breach of warranty claims is barred by the contractual liability exclusion. There is law in some jurisdictions holding that breach of warranty claims, express or implied, are founded upon a contract and are therefore excluded. Some jurisdictions hold that warranty claims are not an "occurrence" and that a negligence cause of action is required. Pure economic loss does not qualify as "property damage".

When Excess Coverage Is "Triggered"

It is often said that excess coverage is triggered when the underlying coverage is "exhausted". The word "exhaustion" is commonly used in a general manner without precise interpretation. "Exhaustion" does not necessarily mean "paid". The policy language control and it is possible for excess coverage to be triggered even though an underlying insurer has not actually paid its limits. Interestingly, simply because an underlying insurer does pay its limits does not automatically mean that excess coverage is triggered. Again, the policy language controls. For example, if an underlying carrier chose to pay an un-covered claim, that may not create an obligation on the part of the excess carrier to also do so.

III. GENERAL POLICY PROVISION ISSUES

Differences Between Named Insured, Additional Insured And "Insured"

Typical general liability policies cover three classifications of insureds and the scope of available coverage is not the same. These are the “Named Insured, “Insured” and “Additional Insured”.

The “Named Insured” is the person or entity specifically identified in the policy Declarations as the “Named Insured”. The Named Insured has the full benefits of the policy and is the only one authorized to make changes to it.

The “Who Is an Insured” section of the policy identifies others who have insured status. For example, depending on the organizational structure of the Named Insured the policy may cover members, partners, officers, directors and employees. In general terms, the insureds that are identified in this section are only insured for liability arising as a result of their conduct in the Named Insured’s business. Thus, there may not be coverage for a job-site injury if the tortfeasor was not within the course and scope of his employment at the time.

Joint venture coverage presents different issues. A joint venture is not insured simply because of a Named Insured’s participation in it. Likewise, a Named Insured is not covered for its conduct as a part of a joint venture. Rather, the joint venture must itself be the Named Insured. In situations where the Named Insured is the joint member, its members will be insureds for their conduct in its business.

Difficult situations can arise in an insurance program where certain excess policies follow form and others do not. There may be situations where the entities entitled to “insured” status are different among the insurers in the coverage tower. For example, an upper tier insurer may restrict the identities of the Named Insured(s) listed in the underlying policies. An argument can be made that the eliminated insured(s) nevertheless qualify for insured status and coverage by virtue of the definition of “insured” in the underlying policy(ies) to which the excess policy follows form.

Additional Insured coverage is typically added by endorsement. There are “specific” endorsements and “blanket” endorsements for both ongoing operations and completed operations coverage. Typical issues that arise are whether coverage is limited to vicarious liability; the validity and scope of the contract requiring a Named Insured to afford Additional Insured status; the extent to which the Named Insured was within its course of work for the purported Additional Insured; the extent to which

insurance is "permitted by law"; the scope of the additional insured coverage required by the contract; and, ambiguity in the endorsement itself. Additional Insureds enjoy the full benefits on the Named Insured's policy unless specifically limited by an exclusion.

Impact of The Cross Suits Liability Exclusion On Claims By The Additional Insured Against The Named Insured

In any policy of insurance, particularly where Additional Insured coverage is required, it is important to look for any exclusion that limits coverage for suits between insureds.

Some general liability policies contain an exclusion similar to the following, in part:

> This insurance does not apply to "bodily injury", "property damage", or "personal injury and advertising injury" arising from claims or "suits brought by:
>
> a. Any insured against another insured; …

This exclusion could apply to preclude coverage to a Named Insured (*e.g.* sub-contractor) for a third-party claim by an Additional Insured (*e.g.* general contractor) in an action brought by a developer or homeowner. Apparently recognizing the unfairness caused by this interpretation, some policies have taken a more restrictive approach and exclude suits only by Named Insureds against Named Insureds and Additional Insureds against Additional Insureds. In the professional liability context, the insured versus insured exclusions become increasingly problematic when actions by current or former employees who qualify as "insureds" are brought against the insured company or organization who also qualifies as an "insured" and is the policyholder expecting coverage.

Concurrent Causation to Circumvent Policy Exclusions

While this doctrine has its roots in the first-party property damage context, it has been used in the general liability context and in construction defect claims. Basically, the doctrine holds that if two separate causes converge to cause a loss, one of which is covered and one of which is excluded, there is coverage unless the insurer can affirmatively show that the loss was caused solely by an excluded cause.

This doctrine can apply in multiple different scenarios for both "property damage" and "bodily injury" claims. In the construction defect setting, we have seen this argument made to circumvent mold exclusions in bodily injury cases. The argument that a contractor's defective work which causes water intrusion results in two distinct conditions that trigger an allergic response ("bodily injury") in the claimant – mold and "dust mites". For all practical purposes, it is impossible to isolate the cause of the allergic response to one or the other. Accordingly, there is a potential for coverage irrespective of the exclusion.

Again, in the construction defect setting, this argument can apply to property damage claims. A first-party property policy defective construction exclusion would not bar coverage for water intrusion because water damage was a covered caused of loss as a result of a hurricane and it could not be proven that construction defects were the sole cause of loss.

Concurrent causation issues have also come up in attempts to avoid the pollution exclusion. Some jurisdictions interpret the pollution exclusion broadly to include mold and other naturally occurring substances. Courts in these jurisdictions so far have not applied the concurrent causation doctrine as a work around of these broadly interpreted pollution exclusions.

"Other Insurance" Issues

Where are two or more policies cover the same loss and both contain excess "other insurance" provisions, the clauses are deemed 'mutually repugnant'. Courts will not then recognize the superiority of one excess "other insurance" provision over another. Certain insurers attempt to write super excess provisions making their insurance excess over any other available insurance. Courts are refusing to apply these super excess "other insurance" provisions.

Courts are also disregarding "Other Insurance" provisions where there is a contractual right of indemnification between the parties insured by the relevant policies.

IV. CARRIER CONCERNS

Non-Compliance with Policy Renewal Statutes Thereby Nullifying Subsequent Policy Changes

Insureds are now raising issues that if a carrier did not comply with the notice provisions in a policy regarding policy changes the carrier has then nullified subsequent policy changes. A material change in coverage/policy terms is deemed a non-renewal of the policy. *e.g.* the deletion of the subcontractor exception to the "your work" definition would be deemed a material change. If a carrier fails to properly notice an insured of the non-renewal by noticing the insured of the non-renewal and explaining the reason of the non-renewal, then the insurer is at jeopardy for nullifying those added or deleted policy terms.

Inadequate Reservation of Rights Letters Resulting In Waiver

It is important that any agreement to defend be accompanied by an adequate Reservation of Rights letter. These letters must specifically advise the insured of the policy provisions, in relation to the facts, which may serve as limitations to coverage. Not doing so may result in a waiver/estoppel of coverage defenses. A variety of courts have further held that an insurer is affirmatively obligated to inform its insured of the need to secure a verdict form in the liability action allocating between covered and potentially un-covered damages. A failure to do so may result in an insurer paying for damages not covered under its policy. A Reservation of Rights letter alone does not satisfy this requirement.

V. CONSENT JUDGMENTS

Any decision by an insurer to deny a defense leaves it exposed to an agreed-consent judgment between its insured and the claimant. If a liability insurer is informed of an action against its insured and declines to defend, it is bound to a consent judgment between the claimant and the insured absent a showing of fraud or collusion. The amount of the judgment may exceed the policy limits. The insured, or its assignee, has the burden to prove: (1) that the insurer wrongfully refused to defend the insured; (2) that the insurer had an indemnification obligation under the policy; and (3) that the settlement with the claimant was reasonable and in good faith. Insurers are also unable to raise any defenses to claims that they believe would have mitigated or voided the damages figured. The rationale being that if the insurer wanted to have that argument raised, they should have defended their insured and asserted that argument.

VI. INSURED'S REJECTION OF A CONDITIONAL DEFENSE UNDER A RESERVATION OF RIGHTS

In many jurisdictions, an insured, is not obligated to accept an insurer's conditional defense and may reject the reservation. It can also accept the defense and later reject it if the insurer materially changes its position. Upon proper rejection, an insured may take control of its own defense and is not subject to a forfeiture of coverage based on the lack of cooperation. An insured's subsequent settlement of an action against it without the insurer's consent does not relieve the insurer of its obligation to pay under the policy. However, once the insured accepts the defense under a reservation of rights, it is obligated to cooperate with the insurer and cannot settle without the insurer's consent.

The most common solution to a situation where an insured rejects a reservation of rights is to secure mutually agreeable counsel. Another possibility is to agree to afford an unconditional defense and reserve on indemnity. The key is to eliminate any conflict of interest that may exist by the use of unilaterally retained defense counsel.
