dri™ The Voice of the Defense Bar

Covered Events

The newsletter of the Insurance Law Committee

07/17/2018

2018 Issue 6

Committee Leadership

In This Issue

Leadership Notes

Note from the Editor

By Shanda Pearson

Summer has officially arrived, and what better to grab for some good summer reading at the lake than this issue of *Covered Events*! In addition to a great slate of case summaries, this edition features a timely article written by Beth Jenson Prouty contemplating agricultural claims and coverage issues that can potentially arise from "Life on the Farm."

Please continue to keep *Covered Events* in mind when you see a new court decision in which our readers may have an interest! You can submit a case summary of a recent court decision to any one of the *Covered Events* editors for potential inclusion in an upcoming issue. Also, if you are interested in writing a featured article for an upcoming edition of *Covered Events*, please contact your ILC substantive law subcommittee chair for more details.

Finally, even though your thoughts may be geared toward sunshine, cherry pie, and fireworks, it is not too early to start making plans to attend DRI's Insurance Coverage and Practice Symposium. The seminar is scheduled to take place on November 29 and 30 at the Sheraton New York Times Square Hotel in New York. Mark your calendar now and look for a brochure and registration information coming soon!

Shanda Pearson is staff counsel for Federated Mutual Insurance Company in Owatonna, Minnesota. She has been an active leader in the DRI Insurance Law Committee, having previously served as webcast chair before her current role as Covered Events editor. Ms. Pearson is also a member of the DRI Corporate Counsel Committee.

DRI's Northeast Regional Claims Conference

By Charles W. Browning

On September 27, 2018, at the Hartford (CT) Hilton, the DRI Insurance Law Committee will once again host DRI's Northeast Regional Claims Conference. Now in its fourth year, and always heavily attended by in-house insurance lawyers and claim professionals, this one-day insurance conference has grown into a must-not-miss-event. This year's Hartford conference will once again bring the country's top insurance professionals to the city that has been the home of liability insurance to discuss the latest cutting-edge insurance coverage and bad faith issues and provide unsurpassed networking opportunities for all. More information to follow soon, but mark your calendars now!

Charles W. (Chuck) Browning is a partner at Plunkett Cooney in Bloomfield Hills, Michigan, where he oversees the firm's nationwide insurance coverage and bad faith practice. He is annually listed in the publication The Best Lawyers in America, and is a Super Lawyer and Leading Lawyer. Mr. Browning is a Fellow in the American College of Coverage and Extra Contractual Counsel. He is a longtime member of the Steering Committee of DRI's Insurance Law Committee and is the 2016 Recipient of DRI's Albert H. Parnell Outstanding Program Chair Award.

Unfair Claims Settlement Practices Compendium

By R. Brandon McCullough

DRI recently published its Unfair Claims Settlement Practices Compendium. The compendium surveys the law on insurance claims practices in all 50 states, the District of Columbia, and the U.S. Virgin Islands. The compendium addresses each state's response to the NAIC's Model Unfair Claims Settlement Practices Act, and directs the reader to the state's statutes or rules where the various unfair claims practices and timing provisions can be found. Each chapter also provides practice tips related to insurance claims practices.

I had the honor of serving with Cathy Sugayan and Matt Haar as co-editors-in-chief for the compendium. Many thanks go out to the over 60 fellow ILC members (and non-ILC members) who authored and edited chapters for the compendium, as well DRI's Publication Services Department staff, for the tremendous amount of time and effort they devoted to its creation.

The compendium promises to be an invaluable resource for claim professionals, in-house counsel, and outside insurance defense and coverage counsel, especially when dealing with a claim in an unfamiliar state. It also makes a great gift for colleagues and clients!

Click here to for additional information and to order your copy today!

R. Brandon McCullough is an attorney with Houston Harbaugh P.C., in Pittsburgh, Pennsylvania. He concentrates his practice on insurance coverage and bad faith litigation, business litigation, and appellate litigation. He litigates and counsels clients on a wide array of coverage disputes involving numerous types of personal and commercial lines policies, and frequently defends insurers in bad faith suits. Mr. McCullough is an active member of the Insurance Law Committee of DRI, where he currently serves as Compendium Vice Chair, Chair of the Young Lawyers Subcommittee, and Vice Chair of the State Mobilization Initiative.

Feature Article

Life on the Farm

Coverage When Something Goes Wrong

By Beth A. Jenson Prouty

With the advent of spring, those of us in the Midwest do not have far to travel to see the newly turned soil of fields being planted, or to watch newly born calves frolicking in the fields. It must be the coverage lawyer in me, but when I encounter these pastoral scenes, my thoughts turn to questions of risk management, such as: What insurance is available if something goes wrong? What if the crop yield is less than it was warranted to be? What if livestock does not grow or reproduce as it was guaranteed to do?

Agricultural claims provide for a fascinating walkthrough of insurance coverage law under the Commercial General Liability ("CGL") insurance policy. No state has developed a large body of case law in the area. But the law that exists around the country provides a roadmap of key issues to consider the next time you are asked to give advice on coverage for claims alleging that an insured has misrepresented its product or work (*i.e.*, the characteristics or effectiveness of its fertilizer, seed, food additive, or livestock)—or that the insured's work (*i.e.*, applying fertilizer) or product (*i.e.*, selling diseased plants or livestock) has caused damage to a third-party's property. For purposes of this article, these claims are collectively referred to as "agricultural claims."

Property Damage Coverage Under the CGL Policy

For an agricultural claim to fall within Coverage A of the standard ISO CGL Coverage Form CG 00 01 04 13, it must allege both "damages because of … 'property damage'" and an "occurrence." Each of these requirements is considered below.

"Damages Because of … 'Property Damage'"

Claims of less-than-anticipated crop yield or reduced growth or reproductive rate of livestock pose the question of whether the losses are solely economic damages, or whether they are premised on some underlying "property damage" that falls within the insuring agreement of Coverage A of the standard CGL policy. Some jurisdictions hold that economic loss, such as diminution in value of tangible property, or a loss of investment, alone can be "damages because of … 'property damage.'" But most jurisdictions hold that economic damage can only be recovered as "damages because of … 'property damage'" when the diminution in value is the result of actual physical damage to tangible property. In those states, the question becomes whether claims alleging damages for loss of the anticipated future income from crops or livestock allege "damages because of … 'property damage.'"

Property Damage: Physical Injury to Tangible Property

The CGL Policy defines "property damage" in two ways: as "[p]hysical injury to tangible property," and as "loss of use of tangible property that is not physically injured." Courts have struggled to apply a consistent analytical framework for determining what constitutes "physical injury to tangible property."

The CGL Policy does not define the terms "physical injury" or "tangible property." Courts have defined "physical injury" as "an alteration in the appearance, shape, color or in other material dimension." *Phibro Animal Health Corp. v. Nat'l Union Fire Ins. Co.*, 142 A.3d 761, 771-72 (N.J. Super. Ct. 2016) (citing cases). It has also been defined as "damage or harm to the physical condition of a thing." *Id.* at 772 (quoting *Farm Bureau Mut. Ins. Co. v. Earthsoils, Inc.*, 812 N.W.2d 873, 876 (Minn. App. 2012), *review denied*, No. A11-0693 (Minn. 2012)). "'Tangible' ordinarily means '[d]iscernible by the touch; palpable' or '[p]ossible to touch.'" *Earthsoils*, 812 N.W.2d at 876 (quoting *American Heritage Dictionary* 1767 (4th ed. 2006)). Thus, "physical injury to tangible property" "involves damage to the physical condition of a palpable item of property." *Id.*

In applying this definition of "property damage" to claims alleging a less-than-anticipated crop yield, courts have drawn a distinction between claims alleging the insured's work or product has merely failed to enhance the yield or livestock as the insured warranted that it would do, which do not allege "physical injury to tangible property," and claims alleging an insured's work or product has affirmatively diminished or reduced the crop yield, which do allege "physical injury to tangible property."

For example, in *Earthsoils*, 812 N.W.2d at 876, Earthsoils recommended a fertilizer and represented that it was of sufficient quality and quantity to produce 180-200 bushels of corn per acre. The corn crop produced less than half of the represented yield, and the Ptaceks subsequently sued Earthsoils for failure to deliver fertilizer of the promised quality. The Ptaceks alleged the fertilizer provided insufficient nitrogen which caused the corn plants to develop poorly: the plants "exhibited yellowing of the leaves, an inconsistent growth pattern, and produced less than one-half of the number of cobs that were anticipated." The Minnesota Court of Appeals concluded that the Ptaceks' claim against Earthsoils did not allege any "physical injury to tangible property" because the liability claim alleged only that the fertilizer produced a lower-than-advertised corn crop, and did not allege the crop produced less than it would have without any fertilizer, or that the corn cobs actually produced were damaged or unmarketable. *See also Mid-Continent Cas. Co. v. Sullivan*, 2008 WL 5412835 (E.D. Ark. 2008) (claim alleging insured applied little or no fertilizer to corn crop, resulting in a poor crop production and damages in excess of $200,000, did not allege any physical injury to tangible property; there was no claim the quality of the harvested cotton was affected or the market price for the cotton lowered); *Krueger Seed Farms, Inc. v. Szlarczyk*, No. 200249, 200250, 1999 WL 33453867 (Mich. Ct. App. March 9, 1999) (potatoes could not be sold as certified seed potatoes but could still be sold as seed and were still edible; the farmer's lost profits because the potatoes were less valuable did not constitute damage to tangible property).

By contrast, in *Scottsdale Insurance Co. v. TL Spreader*, No. 6:15CV2664, 2017 WL 4779575 (W.D. La. Oct. 20, 2017), the Western District of Louisiana considered claims that Helena Chemical Company applied a chemical to Wild Farms' rice crop, and that three days later the rice crop began to exhibit physical damage in the form of abnormal stunting, lesions, yellowing, and death. Approximately six days later, an abnormal amount of the rice crop's tillers began to die. The court found a question of fact as to whether the claims alleged "physical injury to tangible

property." In *Ferrell v. West Bend Mutual Insurance Co.*, 393 F.3d 786, 789 (8th Cir. 2005), the court found a duty to indemnify where an insured's plastic film that was laid over tomato plants deteriorated prematurely, made it difficult to water the plants, and caused blight. These problems resulted in stunted plants that produced less fruit, and smaller tomatoes that suffered from sunburn, rain damage, and cracked stems. One of the tomato growers "testified that the quality of the crop with the defective film was worse than if no film had been used at all." *See also Auto Owners Ins. Co. v. Harrell's Fertilizer, Inc.*, No. 4:05-cv-39, 2006 WL 156742 (E.D. Ten. Jan 20, 2006) (finding a duty to defend claims alleging fertilizer "damaged, stunted the growth of, or destroyed Stoner Nursery's plants, making them unmarketable or unsalvageable").

In the context of claims alleging economic loss for the reduced growth or reproductive rate of livestock, the distinction between what is and is not "physical injury to tangible property" is not always so consistently applied.

Triple U Enterprise, Inc. v. New Hampshire Insurance Co., 576 F. Supp. 798, 800–01, 806–07 (D.S.D. 1983), *aff'd in relevant part*, 766 F.2d 1278 (8th Cir. 1985), concerned a sale of buffalo warranted to be fit for breeding purposes but were later alleged to be unfit for breeding. There the court held that a claim seeking damages for buffalo that should have been born, but were never born, did not allege "physical injury to or destruction of tangible property." But claims for damage to calves that were born after the sale–and were unfit for breeding because they had contracted brucellosis during the birthing process–did allege "property damage." In *Madison Farmers Mill & Elevator Co. v. Mutual Service Casualty Insurance Co.*, No. C9-88-1620, 1989 WL 7596 (Minn. App. Feb. 7, 1989), the Minnesota Court of Appeals found a duty to defend when evidence was produced that the insured's feed caused physical damage to pheasants' reproductive systems, resulting in decreased egg production. The court noted there would not have been a duty to defend if the feed was the cause of the decreased production, and not the physical damage to the pheasants' reproductive systems.

In *Phibro Animal Health*, 142 A.3d at 770–73, the New Jersey Superior Court declined to follow the analysis in *Madison Farmer*, instead holding allegations that an insured's food additive (Aviax) diminished the size and weight of chickens alleged "physical injury to tangible property" even though there was no evidence that Aviax caused any physiological damage to the chickens. While it was undisputed that Aviax was stunting the chicken's rate of growth, and resulted in lower meat production, increased feed costs, and increased processing costs, the undersized chickens were still sold for human consumption, and could have reached their expected weight after being taken off of Aviax. The court held that the chickens' stunted growth was "physical injury" because it was an alteration of their material dimension, and represented harm to the physical condition of the chickens, even if there was no medical evidence of permanent physiological damage. Further, the court held the term "physical injury" did not require the property that was damaged to be rendered unmarketable.

Property Damage: Loss of Use of Tangible Property

Depending on how liability claims are alleged, and the type of damages being sought, the "loss of use of tangible property that is not physically injured" component of the CGL policy definition of "property damage" can be more easily met in a fertilizer or food additive claim than the first definition of "property damage." However, as analyzed below, the "impaired property exclusion" is often applied to exclude coverage for "loss of use of tangible property that is not physically injured."

A "loss of use" agricultural claim alleges a loss of use of an insured's cropland, or loss of use of part of the insured's livestock, and seeks resulting damages for lost profits or diminished value of the cropland or livestock. A "loss of use" claim must still allege a loss of use of "tangible property," and thus does not extend to claims that a crop did not grow, or that livestock was never born. Similarly, a claim alleging damages for loss of anticipated profits from a crop that did not grow or livestock that did not reproduce or grow as warranted would not allege "damages because of" "loss of use of tangible property that is not physically injured." However, a claim seeking to recover the value of lost cropland for a planting season, or diminished value of livestock that were born, but which had a stunted growth rate, allege "damages because of" "loss of use of tangible property that is not physically injured."

For example, in *Stark Liquidation Co. v. Florists' Mutual Insurance Co.*, 243 S.W.3d 385 (Mo. App. 2007), the court held an insured breached its duty to defend a "loss of use" property-damage claim when it was alleged that the insured sold apricot trees that were infected with a bacterial canker, and that the trees did not yield "commercial quantities" of apricots. The damages alleged in the liability complaint were for the "loss of an opportunity" to plant a productive orchard on the 20 acres occupied by the defective apricot tress. In *Hendrickson v. Zurich American Insurance Co. of Illinois*, 85 Cal. Rptr. 2d 622 (Cal. Ct. App. 1999),

the court found a duty to defend where it was alleged the insured sold strawberry plants that had been sprayed with an herbicide which caused systemic damage to the plants, such that the plants died or were stunted. The growers in the underlying liability action did not allege damage to the strawberry plants, but rather claimed that they suffered a loss of strawberry production because they had had relied on the insured's advice that the strawberry plants would still produce a "near normal" yield and had not replanted their fields with healthy plants. The court held the growers' claim alleged a "loss of use of their land," and that the alleged loss of profits or diminution in property alleged damages from the loss of use of the growers' land, and not solely economic losses. *See also Western Cas. and Sur. Co. v. Budrus*, 332 N.W.2d 837 (Wis. Ct. App. 1983) (property damage was alleged where insured sold mislabeled seeds, as farmer lost the use of his 40-acre field due to crop loss and loss of production during planting season).

In *Phibro Animal Health*, 142 A.3d at 773–74, the New Jersey Superior Court held that—even if allegations that an insured's food additive diminished the size and weight of chickens did not allege "physical injury to tangible property"—the claims alleged a "loss of use of tangible property that is not physically injured." The court rejected the insurer's argument that "[c]hicken meat/weight that never existed in the first instance cannot be considered tangible property," holding instead that "the *chickens* themselves did exist," and that the inability to realize the chickens' full potential for sale because of the adverse side effects of Aviax "qualifies, at the very least, as a partial 'loss of use.'"

The "Occurrence" Requirement

For a claim to fall within Coverage A's insuring agreement, the claim must allege both "damages because of … 'property damage'" and that the property damage was "caused by an 'occurrence.'" An "occurrence" is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

Agricultural claims will most often allege an "occurrence," because an insured does not intend that its work or product be defective and/or that its work or product harm a third-party's crop or livestock. *See e.g., Phibro Animal Health*, 142 A.3d at 767–70 (Phibro did not intend or expect to harm its customers' chickens); *Ferrell*, 393 F.3d at 795 (damage to tomato plants that occurred as a result of deterioration of the insured's plastic film was "accidental and unintentional" and thus alleged an "occurrence"); *Stark Liquidation*, 243 S.W.3d at 393 ("there is no evidence that Stark either intended or expected the crop loss and attendant economic damage that occurred as a result of the presence of the bacterial canker").

Some courts have held that claims alleging that the insured's work or product did not produce the results that the insured warranted do not allege an "occurrence," because the claims are based on the quality of the insured's work or product, and that is something entirely within the insured's control. *See e.g., Mid-Continent Cas. Co. v. Sullivan*, 2008 WL 5412835, at *2 (E.D. Ark. 2008) (claim alleging breach of contract and economic damages for lack of crop yield because the insured failed to fertilize all of the crop alleged only poor workmanship and breach of contract); *Earthsoils*, 812 N.W.2d at 879 (noting in dicta that claims against Earthsoils for breach of contract because its fertilizer did not enhance the crop as warranted were precluded under the business-risk doctrine); *E.K. Hardison Seed Co. v. Continental Cas. Co.*, 410 S.W.2d 729, 735 (Tenn. Ct. App. 1966) (no "occurrence" where the only allegation was that the insured misrepresented the quality of seeds that it provided).

Common Exclusions Considered

Even if a claim alleges "damages because of … 'property damage'" caused by an "occurrence," policy exclusions may still preclude coverage for agricultural claims. Courts have not addressed exclusions as substantively as they have considered whether an agricultural claim alleges "property damage," but several decisions provide a roadmap of potentially applicable exclusions.

Exclusion m: The "Impaired Property" Exclusion

The "impaired property exclusion" excludes coverage for "property damage" to "'impaired property' or property that has not been physically injured, arising out of: (1) [a] defect, deficiency, inadequacy or dangerous condition in 'your product' or 'your work'; or (2) [a] delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms."

The exclusion contains an important exception for "loss of use of other property arising out of sudden and accidental physical injury to 'your product' or 'your work' after it has been put to its intended use."

The "impaired property exclusion" is a key exclusion for claims that are alleging "property damage" based on "loss of use of tangible property that is not physically injured." *See e.g., Hayden v. Mut. of Enumclaw Ins. Co.*, 141 Wash. 2d 55, 66 & n.4 (Wash. 2000) (impaired property exclusion applied to claims alleging the farm sustained a crop loss

because of the insured's deficient performance on a contract to graft fruit buds onto farm's rootstock to create fruit trees); *Western Heritage Ins. Co. v. Green*, 54 P.3d 948, 950 (Idaho 2002) (exclusion applied to loss of use of soil caused by insured's insufficient application of fertilizer); *but see Budrus,* 332 N.W.2d at 840 ("loss of use" exclusion did not apply to action against insured for negligently selling improperly tagged seed which resulted in crop loss because product delivered went beyond merely failing to meet represented level of performance).

In *Phibro Animal Health*, 142 A.3d at 777–78, the court found a question of fact as to whether chickens that had delayed growth because they were fed Aviax fell within the definition of "impaired property" so that the "impaired property exclusion" applied. "Impaired property" is defined as tangible property, other than the insured's product or work, that cannot be used or is less useful because it incorporates the insured's product or work, and property that can be restored to use by the repair, replacement, adjustment or removal of the insured's work or product.

In *Phibro*, the chickens were tangible property other than the insured's product or work, and they were less useful because they incorporated the insured's product (Aviax). The issue was whether the chickens could be restored to use by removal of the Aviax. The insurer argued that the chickens could be restored to use, because the chickens would continue to grow to their expected weight after Aviax was removed from their diet. Phibro argued the chickens could not be "restored to use" because it was not commercially feasible to delay the slaughter of the chickens and they could not be restored by the pre-determined slaughter date. The court defined "restored to use" as taking "into account the cost and commercial feasibility of restoration," and remanded the case for an evaluation of whether "the chickens reasonably and feasibly could be restored to their normal size and weight within a commercially viable time frame and at commercially reasonable cost."

Any evaluation of the "impaired property exclusion" must also include consideration of whether the exception to the exclusion applies—that is, when the insured's work or product has been put to its intended use, and whether any "loss of use" arises out of "sudden and accidental physical injury" to the insured's work or product after it has been put to that use. Courts have yet to substantively address this exception in the context of an agricultural claim. *See Stark Liquidation*, 243 S.W.3d 385 at 396 (summarily concluding that exception to the impaired property exclusion applied because the insured's "negligent introduction of bacterial canker into the apricot trees caused sudden and accidental physical damage to the trees and, as a result, [the plaintiff] lost the use of his orchard"); *Phibro Animal Health*, 142 A.3d at 778 (remanding the case for consideration of whether the injury to the insured's product or work occurred after the product or work "has been put to its intended use" so that the exception to the exclusion applied).

The "Your Product" Exclusion

The "your product" exclusion excludes "property damage" to an insured's product, "arising out of it or any part of it." "Your product" is defined, in part, to mean: "Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by: (a) You; (b) Others trading under your name; or (c) A person or organization whose business or assets you have acquired."

The key to determining if the "your product" exclusion applies in an agricultural claim is whether the claim is alleging damage to the insured's work or product—or if it is alleging that the insured's work or product caused damaged to a third party. *See e.g., Stark Liquidation*, 243 S.W.3d at 395 ("your product" exclusion did not apply because liability plaintiff did not claim damage to the insured's product (the infected apricot trees)); *North Branch Mut. Ins. Co. v. Bloom Lake Farms, Inc.*, No. C9-95-762, 1995 WL 553875 (Minn. App. Sept. 19, 1995) (claims alleging the insured sold a herd that was in poor condition and did not produce milk or calves at the level anticipated were excluded because the herd was the insured's "product").

Claims alleging that an insured provided a defective seed, and that the seed resulted in a decreased yield, are not excluded because while the seed is the insured's product, the resulting crop belongs to a third party. For example, in *Delta & Pine Land Co. v. Nationwide Agribusiness Insurance Co.*, 530 F.3d 395 (5th Cir. 2008), the underlying liability claim alleged that farmers had suffered substantial losses in crop yields because Delta & Pine Land Company ("DPL") had negligently sold cotton seeds that included a blend of new and old seeds. Nationwide argued that the decreased cotton yield was damage to DPL's own product, the cotton seed. But the court found that while the seed was DPL's product, the resulting crop and the farmer's use of the crop land were the farmer's separate property. *Id.* at 403 (citing *St. Paul Fire & Marine Ins. Co. v. Northern Grain Co.*, 365 F.2d 361, 368 (8th Cir. 1966) ("By virtue of the germination process involved in the production of wheat a transformation did, in fact, occur so as to constitute the

wheat crop a separate and distinct entity from the original seed wheat.")).

A similar rational applies to claims involving livestock. In *Triple U Enterprises*, 527 F. Supp. at 810, there was no coverage for claims alleging the insured sold diseased buffalo. But the "your product" exclusion did not apply to calves born after the sale that were infected with the disease during the birthing process. Just as there is a difference between wheat seed and the resulting wheat crop, "calves born constituted a separate and distinct entity from the original buffalo sold."

Exclusion J.(5): Work in Progress; Exclusion J.(6): Repair of Incorrect Work

Exclusion j.(5) excludes coverage for property damage to "that particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations."

Exclusion j.(6) is quite similar to j.(5). It excludes coverage for "'[p]roperty damage' to … [t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." Exclusion j.(6) contains an exception for "'property damage' included in the 'products-completed operations hazard.'" The products-completed operations hazard ("PCOH") exception has the effect of limiting exclusion j.(6) to property damage that occurs while the insured's work is ongoing. It also defines when the insured's work is deemed completed, including "[w]hen all of the work called for in your contract has been completed," and "[w]hen that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project."

In *TL Spreader*, 2017 WL 4779575, at *6–8, it was alleged that the insured damaged a rice crop by failing to "neutralize" a chemical in its spray rigor before applying certain herbicides and pesticides to the rice filed. The issue in the case was whether the PCOH exception to j.(6) applied to restore coverage. The insured alleged that the damage to the rice crop did not begin to occur until after its work under the contract was completed because the rice crop did not begin to exhibit physical damage until three days after the spraying was completed. The insurer countered that the crop was inevitably damaged at the time the fertilizer was applied, and so the damage occurred while the insured's work was ongoing. To determine when the property damage to the rice crop occurred, the court considered whether Louisiana would adopt an "exposure theory" (at the time the fertilizer was applied) or a "manifestation theory" (at the time the damage manifested) to determine when property damage had occurred. The court adopted the manifestation theory, and concluded that the property damage to the rice field occurred not when the application of fertilizer was made, but when the property damage to the rice became obvious. Thus, the court applied the PCOH exception to restore coverage, because "damage to the rice crop did not manifest until several days after completion of the work."

In contrast, in *Brake Landscaping & Lawncare, Inc. v. Hawkeye-Security Insurance Co.*, 625 F.3d 1019 (8th Cir. 2010), the court held the PCOH exception did not apply to claims that an insured mistakenly sprayed its customers' lawns with the wrong herbicide over a period of eight days. There was testimony in the case that once the herbicide was applied, it would "immediately begin[] to kill the plant, although actual plant death usually does not occur until seven to ten days later." The court did not focus on whether to apply the manifestation or exposure theory of when property damage occurs, but rather concluded that the PCOH exception did not restore coverage because the damage to the lawn occurred *while* the insured was spraying the herbicide. The parties did not dispute that, after the application of the herbicide, the death of the vegetation was inevitable and irreversible, even though it took several days to manifest.

Other common issues to consider when applying exclusion j.(5) and j.(6) to agricultural claims is whether to broadly or narrowly define "that particular part of any property" on which the insured is working, and whether the exclusion applies when the insured's work is correctly performed, but it is alleged the work was performed in the wrong place.

Exclusion J.(4): Personal Property in the Care, Custody or Control of the Insured Exclusion

Exclusion j.(4), the "care, custody, or control exclusion," excludes coverage for property damage to "personal property in the care, custody or control of the insured." "The exclusion [is] intended to prevent a CGL policy from serving as property insurance when property is in the hands of a bailee or lessee, or when in the custody and control of a named insured and therefore subject to damage or loss due to the named insured's own acts or omissions." 3-18 Martha A. Kersey, *New Appleman on Insurance Law Library Edition* §10(g) (2014).

In *Green,* 54 P.3d at 950, the Idaho Supreme Court applied the "care, custody, or control exclusion" to claims that

the insured applied insufficient fertilizer to a third-party's potato plants. As a result, large weeds grew, the potato foliage yellowed and started to die, fewer potatoes were harvested, and many of the potatoes actually harvested were unmarketable because they were slimmer, rougher, blemished, and hooked. The Court concluded the soil was in the care, custody and control of the insured when they applied fertilizer to the soil.

Conclusion

In 2012, a colleague and I handled the insurer's successful appeal in the *Farm Bureau v. Earthsoils* case before the Minnesota Court of Appeals. Ever since, I have been fascinated by the area of coverage for agricultural claims, and the many coverage issues that it creates. Consideration of the issues analyzed above should have you well on your way to analyzing coverage for your next agricultural claim.

Beth Jenson Prouty is an attorney at the Arthur Chapman law firm in Minneapolis, Minnesota, where she regularly advises and defends insurance carriers in claims involving CGL, Auto, Homeowners, and Professional Liability coverage. Beth also handles numerous appeals and has a broad-ranging insurance defense practice, including the defense of insureds in claims involving discrimination, employment, business litigation, and professional liability. *Special thanks to Steve Warner, Esq., who also assisted in the preparation of this article.*

Recent Cases of Interest

Second Circuit

"Accident"/"Occurrence" (NY)

Hough v. USAA Casualty Insurance Company: Second Circuit Finds No Coverage Where Insured Intentionally Ran Someone Over in Road Rage Incident, Thus There Was No "Accident" Under the Policy.

The facts in this case are critical: Hough was working as a flagman on Sixth Avenue in Manhattan on the morning of August 3, 2000. Margulies was driving a car north on Sixth Avenue, on his way to a meeting with former Governor Mario Cuomo, and running late. Hough was managing traffic. Margulies was stopped by Hough, his car first in the line. Hough continued to hold traffic, even though it seemed no vehicles were entering or exiting the construction site. Margulies became increasingly impatient as he watched the traffic light at 23rd Street pass through two full cycles without seeing any trucks enter or leave the site.

Margulies testified he made eye contact with Hough to communicate his intention to proceed when the light turned green regardless of Hough's instructions. When the light changed to green, Margulies lifted his foot off the brakes and his car rolled forward slowly. Hough was not in Margulies's lane when the car started moving forward, but stepped back into the lane when the car was about a car length away. Hough did not move, and the car continued to move forward. Margulies testified that he expected Hough to move, and thought Hough was staying put simply to annoy Margulies. Margulies continued to allow the car to move forward toward Hough, and did not apply the brakes until after the car hit Hough. Margulies saw Hough fall and get back up, stated he assumed Hough was unhurt, and continued up Sixth Avenue to his meeting. Margulies subsequently pled guilty to misdemeanor assault in the third degree under N.Y. Penal Law §120.00(2).

Hough sued Margulies for negligence in state court. Neither Margulies nor his carrier (USAA) defended the action, and thus a default judgment was entered in the amount of $4.8 million. Hough then sued USAA directly, pursuant to the direct action statute of Insurance Law 3420. After Margulies filed for bankruptcy, Hough started an adversary proceeding seeking to find the debt declared non-dischargeable since Margulies had acted willfully, and also for USAA to be held liable since the incident was an "accident" under the policy.

At issue before the Second Circuit was whether the incident was indeed an accident, for if it was intentional there would be no liability coverage for it. In short, the court found that the incident had been intentional from the standpoint of the insured. Under New York insurance law, an injury is "intentionally caused and thus not accidental if the damages . . . flow directly and immediately from an intended act rather than a chain of unintended though expected or foreseeable events that occurred after an intentional act." Here, Hough's injuries "flowed directly and immediately from Margulies's decision not to apply the car's breaks until after the car struck Hough." As such, this

was no accident and no occurrence for which there could be coverage.

Agnes A. Wilewicz
Hurwitz & Fine, P.C.

Fifth Circuit

Equitable Lien Doctrine (TX)

***Sierra Equip., Inc. v. Lexington Ins. Co.*, No. 17-10076, --- Fed. Appx ---, 2018 WL 2222695 (5th Cir. May 15, 2018).**

The U.S. Court of Appeals for the Fifth Circuit held that Sierra Equipment Inc. (Sierra) lacked standing to sue Lexington Insurance Co. (Lexington) as Sierra was not identified in any loss payable clause in the property insurance policy that Lexington issued to LWL Management Inc. (LWL). Sierra had leased equipment to LWL under a lease agreement that required "LWL to insure the leased equipment, deliver a copy of the insurance policy to Sierra, and obtain a policy in form, in terms, in amount, and with insurance carriers reasonably satisfactory to Sierra." The agreement did not "require that the policy list Sierra as an additional insured or contain a loss payable clause listing Sierra."

After discovering that the equipment LWL had leased was lost, damaged or destroyed, Sierra initiated suit against Lexington seeking recovery under the policy. Lexington, however, argued that Sierra lacked standing to maintain such a suit. The appellate court first recognized that an "insurance policy is a personal contract between the insurer and the insured named in the policy and a stranger to the policy may not ordinarily maintain a suit on it." The appellate court also recognized that the equitable lien doctrine represented an exception, applying "in such instances as those where a mortgagor or lessee is charged with the duty of procuring such a policy with loss payable to the mortgagee or lessor."

Sierra argued its lease agreement with LWL qualified as such an agreement, especially as "LWL was required to deliver the insurance policy to Sierra and obtain a policy in terms satisfactory to Sierra." The appellate court ultimately disagreed, finding that "the agreement between Sierra and LWL did not require that LWL obtain insurance with a loss payable clause to Sierra … [a]nd the Lexington policy does not contain such a clause[,]" such that "Sierra, who was not a party to the insurance policy, does not have standing to sue Lexington."

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Eighth Circuit

First Party / Business Income (AR)

***Welspun Pipes Inc. v. Liberty Mutual Fire Ins. Co.*, No. 17-1470, --- F.3d ---, 2018 WL 2376479 (8th Cir. May 25, 2018).**

The U.S. Court of Appeals for the Eighth Circuit held that Liberty Mutual Fire Insurance Company (Liberty Mutual) need not provide coverage for expenses incurred by Welspun Pipes Inc. (Welspun) when it moved production overseas following a fire at its Little Rock plant. The Liberty Mutual policy covered loss of income, as well as certain expenses incurred to mitigate the loss of income, during a time period defined in the policy. Welspun sought coverage for business income as well as more than $13 million in expenses associated with moving production to India in order to comply with contract deadlines. The appellate court agreed with the district court's finding that these expenses were not covered because they were not "necessary" costs (as defined in the policy) that mitigated Welspun's lost income amounts that would need to be covered by Liberty Mutual. The appellate court noted that Welspun's reading of the policy would actually increase Liberty Mutual's obligation to an amount higher than if the insured had not mitigated the loss at all—an outcome that was specifically made impermissible by the policy.

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Ninth Circuit

Punitive Damages (CA)

The Ninth Circuit ruled in *Paul Evert's RV Country, Inc. v. Universal Underwriters Ins. Co.*, No. 17-15730 (9th Cir. Apr. 25, 2018) (unpublished), that a liability insurer defending

an insured has no duty under California law to indemnify its insured for punitive damages.

Michael Aylward
Morrison Mahoney

"Collapse" (WA)

***Am. Econ. Ins. Co. v. CHL, LLC*, --- Fed. Appx. ---, No. 16-35606, 2018 WL 2140444 (9th Cir. May 9, 2018).**

The U.S. Court of Appeals for the Ninth Circuit affirmed a district court ruling that American Economy Ins. Co. (American Economy) had no obligation to cover apartment complex owner CHL LLC's (CHL) costs to repair damage to an apartment building because it did not suffer a "collapse." CHL carried six consecutive policies with American Economy from 1999 to 2005. The first three policies did not define "collapse," but each policy from 2002 onward defined the term as an "actual falling down" of at least part of the apartment building. In 2014, CHL renovated the apartments and discovered significant decay in several structural components. An engineer retained by American Economy found that the components had reached a point of "substantial structural impairment" sometime between 1999 and 2002, and concluded that the apartment building could be classified as dangerous unless it was repaired. American Economy denied coverage for CHL's repair costs and filed a declaratory judgment action, saying its expert had determined that CHL's damages were caused by faulty construction in 1988, outside of the earliest policy period. American Economy also argued that to the extent any structural damage began between 1999 and 2001, that damage is not covered because it does not constitute an imminent threat of collapse. CHL pointed to the statements of American Economy's engineer as evidence that its apartment building was in a state of collapse beginning in 1999.

The Washington Supreme Court previously defined "collapse" to require an impairment "so severe as to materially impair a building's ability to remain upright." The district court noted that the building remained standing without renovation until 2014 and held that the use of the word "unsafe" in the Washington Supreme Court's Queen Anne Park decision was merely a "gloss on the first definition it had given for a building in a state of collapse: a building suffering from a 'severe impairment' of its 'ability to remain upright.'" In avowing the district court's reasoning, the appellate court noted that where the evidence showed that the framing of CHL's building was still capable of supporting weight prior to the repairs, CHL's arguments ignored a crucial part of the "collapse" definition, which requires that the damage to a structure be so severe that it impairs the building's "ability to remain upright." The appellate court affirmed the summary judgment ruling in favor of the insurer.

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Accrual of Bad Faith Claims (MT)

Deitz v. GEICO General Insurance Company (5/11/18): Third Party Bad Faith Claims in Montana Accrue on the Date of the Settlement or the Entry of Judgment on the Underlying Claim.

Dietz appealed from the district court's dismissal of his claims for statutory and common law third-party insurance bad faith against Geico General Insurance Company (Geico).

In August of 2009, Geico's insured, Hillary Bouldin, injured Dietz in a car accident. Ultimately, the matter proceeded to trial, where the jury awarded Dietz $15,000.00 in damages. On April 18, 2013, the Clerk of Court entered judgment in Dietz's favor for this amount. Dietz appealed the jury verdict to the Ninth Circuit, which affirmed the jury verdict. Dietz then appealed to the United States Supreme Court, which affirmed the jury verdict on June 9, 2016.

On July 5, 2016, Dietz filed a complaint against Geico asserting a third-party bad faith claim under Montana's Unfair Trade Practices Act (MUTPA) and a common law claim for third-party bad faith. The district court granted Geico's motion to dismiss finding Dietz's claims were time-barred because they accrued on April 18, 2013, when the district court entered judgment on the jury verdict in the underlying tort case.

The MUTPA provides that a third-party claimant must bring an action within 1 year from the date of the settlement of or the entry of judgment on the underlying claim. The Court rejected Dietz's argument that "entry of judgment" refers to anything other than the entry of judgment by the Clerk of Court or the district court at the conclusion of the trial court proceedings. The "entry of judgment" triggering the statute of limitations occurred on April 18, 2013. The MUTPA required Dietz to file his third-party statutory bad faith claim within one year of the April 18, 2013 entry of judgment in the underlying case. Thus, the claim was time-barred.

Dietz also challenged the district court's dismissal of his common law claim for third-party bad faith. The statute of

limitations for bad faith or breach of the covenant of good faith and fair dealing is the three-year statute applicable to torts. All the allegations in Dietz's complaint for common law bad faith accrued on or before April 18, 2013. These claims were also time-barred.

Brian D. Barnas
Hurwitz & Fine, P.C.

Tenth Circuit

Professional Services (CO)

***Evanston Ins. Co. v. Law Office of Michael P. Medved, P.C.*, No. 16-1464, --- F.3d ---, 2018 WL 2306871 (10th Cir. May 22, 2018).**

Evanston Insurance Co. filed suit against foreclosure attorney, Michael Medved (Medved), and his solo practice, alleging that its professional services liability policy did not extend coverage to a suit based on the firm's alleged overbilling practices. Medved represented lenders and investors, and although he billed them directly, the cost of his services was reportedly passed on to property owners. The U.S. District Court for the District of Colorado granted Evanston's motion for summary judgment, and the U.S. Court of Appeals for the Tenth Circuit affirmed, ruling that, under Colorado law, Evanston had no duty to defend Medved or his solo practice from a homeowner class action or an investigation by the state attorney general. The courts reasoned that the policy only covered "professional services," defined as "those services performed by [Medved] for others … as a lawyer," and that billing did not fall within that definition. The record was clear, and Medved acknowledged under oath, that the class action and attorney general's allegations all arose from improper billing practices, not professional services. Medved, nonetheless, argued that his policy covered billing-related suits because it promised coverage for damages "by reason of" professional services. The appellate court disagreed, holding that "by reason of" is much more limited than "arising out of" and is not expansive enough to encompass billing matters.

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Computer Fraud Coverage (GA)

***Interactive Commc'ns Int'l Inc. v. Great Am. Ins. Co.*, --- Fed. Appx. ---, No. 17-11712, 2018 WL 2149769 (11th Cir. May 10, 2018).**

The U.S. Court of Appeals for the Eleventh Circuit held that a computer fraud policy issued by Great American Insurance Company (GAIC) to Interactive Communications International Inc. (InComm) did not cover certain fraudulent debit card transactions. InComm's service allows consumers to purchase a "chit" at a retailer, then call InComm and, through InComm's automated phone line, transfer the value of a chit to a debit card. Fraudsters exploited InComm's automated phone line (controlled by computer software) to redeem the same chit multiple times, causing over $11 million in losses to InComm.

The insurance policy at issue provided coverage for "loss of … money, securities and other property resulting directly from the use of any computer to fraudulently cause a transfer of that property. …" The appellate court disagreed with the district court's ruling that the fraud was not committed through "use of a computer," saying that "use" of a computer did not have to mean that the fraudster knows or intends to use a computer to commit the fraud. However, the appellate court sustained the district court's holding that the fraud did not "result directly" from the use of a computer, because InComm retained control over the funds affected by the fraud for some time. The appellate court concluded there was no coverage under the GAIC policy because, under the clear terms of the policy and the normal definition of "directly," the fraud did not result directly from the use of a computer.

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Declaratory Relief / Diversity Jurisdiction (GA)

The Eleventh Circuit ruled that a Georgia federal district should not have entered a ruling declaring the rights and obligations of primary and excess insurers for a large explosion at the Imperial Sugar plant that killed dozens of workers. In *St. Paul Fire & Marine Ins. Co. v. National Union Fire Ins. Co. of Pittsburgh, PA*, No. 16-12015 (11th Cir. May 29, 2018), the court of appeals held that the interests of St. Paul and one of the defendant insurers (AGLIC) were identical and that AGLIC should therefore have been realigned as a party plaintiff, which would have defeated diversity

jurisdiction because AGLIC and the AIG defendants are all New York corporations.

Michael Aylward
Morrison Mahoney

California

Misrepresentations

The California Court of Appeal ruled in *Monterey Ins. Co. v. 1725 Fulton Street, LLC*, No. A149722 (Cal. App. April 18, 2018), that a trial court erred in granting summary judgment against a liability insurer, finding that there were disputed issues of fact as to whether the insurer had waived its right to raise the defense of misrepresentation, notwithstanding evidence at trial that the insurer had failed to take any action after becoming aware of misrepresentations concerning prior claims.

Michael Aylward
Morrison Mahoney

"Personal Injury" / Invasion of Private Occupancy

The California Court of Appeal ruled in *Albert v. Truck Ins. Exchange*, No. B278295 (Cal. App. May 15, 2018) that a homeowner's insurer was required to defend allegations that a homeowner erected and refused to remove a fence that partially blocked the only road leading to her neighbor's undeveloped property pursuant to the policy's "personal injury" coverage. While agreeing with the Truck that the plaintiff had not alleged a claim for "wrongful entry," the court declared that the policy's coverage for "invasion of the right of private occupancy" was ambiguous and may include non-physical invasions of rights in real property.

Michael Aylward
Morrison Mahoney

"Occurrence" / Negligent Supervision

In its most important ruling so far this year, the California Supreme Court held in *Liberty Surplus Ins. Co. v. Ledesma & Meyer Construction Co.*, No. S236765 (Cal. May 4, 2018), that a liability insurer was obligated to defend allegations that its insured was negligent in its hiring, training and supervision of an employee who sexually assaulted a third party. On a certified question from the Ninth Circuit, the Supreme Court held that such claims constitute an "occurrence" because the insured did not intend for the injury to occur. The court emphasized that the tort of negligent supervision relied on independent acts of negligence and did not rest on theories of vicarious liability for the employee's intentional acts. The court concluded that "[a]bsent an applicable exclusion, employers may legitimately expect coverage for such claims under comprehensive general liability insurance policies, just as they do for other claims of negligence." Justice Liu added a concurring opinion, questioning whether some of the cases cited by the majority were reliable authority in light of the attenuated relationship between the insured's acts and the resulting injuries.

Michael Aylward
Morrison Mahoney

Colorado

UIM / Payment of Undisputed Amounts

State Farm v. Fisher, Supreme Court of Colorado (5/21/18): Supreme Court Affirms Court of Appeals; Jury's Verdict for Insured, Finding Insurer Violated Colorado Statutory Law by Unreasonably Delaying Payment of the Insured's Medical Expenses on a UIM Claim, is Upheld, as well as the Trial Court's Assessment of Statutory Penalties Against Insurer.

The facts of this underinsured motorist ("UIM") case are as follows. Dale Fisher was in a motor vehicle accident in which the culpable other driver only carried $25,000 in liability insurance. Fisher's injuries from the accident required over $60,000 worth of medical care. Fisher's State Farm UIM limits on multiple applicable policies totaled $400,000. State Farm agreed Fisher's medical bills were covered under Fisher's UIM policies, but disputed other amounts Fisher sought under the policies. Fisher asserted a lost wages claim from the accident, and demanded $1.35 million. State Farm consented to the $25,000 settlement of the other driver's policy limits, and offered $59,572.10 to Fisher to settle his UIM claim. State Farm refused to pay Fisher's covered medical bills without first resolving his entire claim, taking the position that Fisher's medical expenses were not, as a matter of law, owed yet, because other portions of Fisher's UIM claim were not yet resolved, and State Farm had no obligation to make piecemeal payments on the undisputed portions of Fisher's claim. Fisher sued, alleging in relevant part, that State Farm unreasonably delayed or denied paying his medical expenses in violation of Colorado insurance law requiring payment of the undisputed medical expenses.

A jury returned a verdict for Fisher, finding State Farm's refusal to pay Fisher's medical bills without first resolving his entire claim constituted a violation of a Colorado insurance statute, Section 10-3-1115 C.R.S., which provides, in relevant part, insurers "shall not unreasonably delay

or deny payment of a claim for benefits owed to or on behalf of any first-party [insured] claimant," and moreover states, "an insurer's delay or denial was unreasonable if the insurer delayed or denied authorizing payment of a covered benefit without a reasonable basis for that action." The trial court entered judgment of $400,000, the UIM policies limit, plus $122,250.32, constituting double medical expenses, a statutory penalty for violation by the insurer of the aforementioned statute. State Farm appealed, but a division of the court of appeals affirmed the jury's verdict, and State Farm was then granted certiorari for review by the Colorado Supreme Court of the following issue arising from the court of appeals' decision: "[W]hether the court of appeals incorrectly ruled that automobile insurers have a duty to advance partial payments on undisputed portions of an uninsured/underinsured ('UM/UIM') claim even though the complete claim has not been resolved."

Colorado's Supreme Court stated, "[u]nder the plain language of section 10–3–1115, we hold that insurers have a duty not to unreasonably delay or deny payment of covered benefits, *even though other components of an insured's claim may still be reasonably in dispute*. Because Fisher's medical expenses were undisputedly covered under the UIM policies, but State Farm failed to pay them, we conclude that the court of appeals properly upheld Fisher's jury award under sections 10–3–1115, –1116. Therefore, we affirm the judgment of the court of appeals." *State Farm Mut. Auto. Ins. Co. v. Fisher*, 2018 CO 39, ¶ 27 (emphasis added).

The term "covered benefit" in the statute is undefined. The court declined to define the statutory phrase "covered benefit" as meaning or contemplating a final, one-time payment of the UIM claim.

It is now clear in Colorado that auto insurers must pay UIM benefits piecemeal on undisputed medical expenses, and presumably on any other undisputed "covered benefits." Failing to do so will expose insurers to risk of a statutory unreasonable delay suit, whereby the UIM claimant will seek double damages, attorneys' fees, and costs.

The court of appeals' affirmation indicates the trial court also awarded Fisher statutory attorney fees of $51,000 and costs of $54,175.21. State Farm apparently did not appeal these awards to the Colorado Supreme Court, limiting its appeal only to the portion of the judgment reflecting the verdict of unreasonable delay of payment of medical benefits.

Finally, for what it is worth, the Supreme Court of Colorado observed in dictum that "State Farm and its amici strongly contend that the court of appeals' holding—which we now affirm—has increased the price of UIM premiums and reduced insurers' ability to detect fraud and inflated claims. Because the plain language of section 10–3–1115 compels the result we reach today, we think such public policy arguments would be better directed to the legislature."

Eric T. Boron
Hurwitz & Fine, P.C.

Bad Faith / Statute of Limitations

On a certified question from a federal district court, the Colorado Supreme Court ruled in *Rooftop Restoration, Inc. v. American Family Mut. Ins. Co.*, 2018 CO 44 (Colo. May 29, 2018), that the one-year statute of limitations found in Section 13-80-103(1)(d), C.R.S. (2017), does not apply to an action brought under Section 10-3-1116(1) for the unreasonable denial or delay of insurance benefits because it is not an "action for any penalty or forfeiture of any penal statute" within the meaning of Section 13-80-103(1)(d).

Michael Aylward
Morrison Mahoney

Connecticut

Subrogation

While the Connecticut Supreme Court adopted a presumption against allowing the insurers of property owners to subrogate against tenants in *DiLullo* in 2002, the court ruled in *Amica Mut. Ins. Co. v. Muldowney*, SC 19794 (Conn. Apr. 10, 2018), that lower courts properly allowed subrogation based on evidence that the terms of the applicable lease put the tenants on notice that they would be responsible for any damages to the leased property and were required to purchase their own insurance policy for the defendants' and the landlord's mutual benefit. In light of facts that the tenants had agreed in the lease to secure an insurance policy for the landlord's benefit, the supreme court declared that allowing subrogation in this case was fair and consistent with the doctrine of equitable subrogation, as the defendants should not have expected that their liability would be covered by the landlord's insurance policy or that some part of their rent payment was intended to pay for the landlord's insurance.

Michael Aylward
Morrison Mahoney

First Party / Bad Faith (NY)

A federal court that a business owner could not recover bad faith damages against its property insurer for providing it with inadequate temporary air conditioners after construction debris clogged its original HVAC system. in granting Sentinel's motion to dismiss the bad faith claims under New York law, Judge Merer ruled in *Quinn Fable Advertising, Inc. v. Sentinel Ins. Co.*, No. 17-1795 (D. Conn. May 2018) that where an insured sues for breach of contract and breach of the implied covenant of good faith and fair dealing based on the same set of fact the implied covenant claim is redundant and should be dismissed. The court also agreed to dismiss the insured's claim for punitive damages in the absence of any suggestion that the insurer acted with an intent to harm the general public.

Michael Aylward
Morrison Mahoney

Florida

Consent Judgment / Bad Faith

Cawthron v. Auto-Owners Insurance Company (M.D. Fla. 04/27/18): Consent Judgment to which Insurer was Not a Party did not Constitute an Excess Judgment or its Equivalent as Necessary for Bad Faith Claim

Cawthorn and his friend Ledford were driving home to North Carolina, returning from a spring break vacation in Florida. Ledford was driving near Daytona Beach in a 2007 BMW owned by his father's business. In route, Ledford fell asleep and crashed the car into a concrete barrier. Cawthorn suffered serious injuries resulting in paralysis from the waist down. He was 18 years old at the time.

The car was insured under an Auto-Owners policy issued to Ledford's father's business, which provided $1 million in primary coverage and $2 million in umbrella coverage. Within two weeks of receiving the claim, Auto-Owners determined that its insureds were at fault for the accident. Upon learning that Cawthorn was paralyzed, a reserve for the policy limits was set. Auto-Owners attempted to negotiate the claim and obtain Cawthorn's medical records pre-suit but were largely unsuccessful. Eventually, Cawthorn hired an attorney who sued the father's business. After receiving initial medical documentation, Auto-Owners tendered the $3 million in coverage. The tender was rejected.

Auto-Owners hired one attorney to represent Ledford and another to represent his father's company. Both Ledford and the company hired personal counsel as well. After mediation, a settlement was discussed, which would have included a $33 million consent judgment with Auto-Owners paying the policy limits. Auto-Owners agreed that it would pay its policy limits and continue to defend Ledford, but declined to be a party to a consent judgment.

A settlement agreement was eventually reached, but Auto-Owners did not sign. Pursuant to the agreement, Ledford agreed to a $30 million consent judgment against him with Auto-Owners tendering $3 million for a full release of the father's company. Cawthorn in turn agreed not to record the consent judgment against Ledford and to deliver Ledford a full and complete satisfaction of the consent judgment regardless of the outcome of a future bad faith suit. Thereafter, Auto-Owners tendered the policy limits, which were finally accepted. On December 20, 2016, the state court entered the consent judgment and Cawthorn filed a bad faith action against Auto-Owners.

Historically in Florida, an excess judgment was required to maintain a bad faith case. However, exceptions to this were carved out. These include Cunningham agreements between insurers and claimants to try the bad faith claim first and Coblentz agreements, which arise where the company fails to defend the insured, and the insured and injured party may enter into an agreement settling the claim and allowing the injured party to pursue a bad faith claim.

Here, the court determined that the bad faith claim must fail because there was no excess judgment or functional equivalent. Auto-Owners was not a party to the $30 million settlement agreement. The consent judgment did not constitute an excess judgment for the purposes of a third party bad faith claim. In addition, the agreement did not constitute a Cunningham agreement because the damages were stipulated to before the bad faith claim was brought. Without an excess judgment, or its functional equivalent, the bad faith claim lacked an essential element and was summarily dismissed.

Brian D. Barnas
Hurwitz & Fine, P.C.

Chinese Dry Wall / Fees / "Damages"

Judge Seitz ruled that the "confession of judgment" doctrine, wherein insureds are entitled to recover their fees for cases that insurers pay after initially disputing them, did not apply to a declaratory judgment action brought by the insured. In *Peninsula Developers II v. Westchester Fire Ins. Co.*, No. 09-23691 (S.D. Fla. April 25, 2018), the district court declared that the public policy behind the doctrine did not apply where the insurer had defended under a

reservation of rights and ultimately paid to settle the case. Further, the court declared that the insured had no right to reimbursement for $381,490 that it had paid towards the settlement as, under California law, the insurer's obligation to indemnify all sums that the insured is legally obligated to pay as damages only applied to court-ordered judgments.

Michael Aylward
Morrison Mahoney

Illinois

Coverage B / Malicious Prosecution / Trigger

In *First Mercury Ins. Co. v. Ciolino*, 2018 Ill. App. (1st) 171532 (Ill. App. Ct. May 11, 2018), the Appellate Court rejected arguments that allegations that a law professor conspired to falsely blame the plaintiff for a murder that he was ultimately found not to have committed should give rise to "personal injury" coverage in the policy year when the claimant was ultimately exonerated. Notwithstanding the claimant's argument that the offense of "malicious prosecution" does not exist until such time as the claimant is exonerated, the sixth division aligned itself with numerous other Illinois precedents on this issue, declaring in that coverage should only arise in the policy year in which the malicious prosecution commenced. The Appellate Court also rejected the insured's argument that he should be entitled to coverage in any event due to an agent's statement to him that the First Mercury policy would cover claims for malicious prosecution, noting that the agent had not specified which policy or policies were being described nor had the plaintiff shown justifiable reliance on any such misrepresentation.

Michael Aylward
Morrison Mahoney

Asbestos / "Horizontal Exhaustion" / Excess / SIRs

The Appellate Court has ruled that the principle of "horizontal exhaustion" articulated by the Illinois Supreme Court a decade ago in *Kajima* requires payment of all primary policies before umbrella insurance policies are triggered. In *Lamorak Ins. Co. v. Kone, Inc.*, 2018 IL App (1st) 163998 (Ill. App. May 15, 2018), the First District ruled that CGL policies issued by Lamorak did not become "excess" insurance merely because they featured self-insured retentions and not deductibles.

Michael Aylward
Morrison Mahoney

Kentucky

Faulty Workmanship / "Occurrence"

Martin/Elias Props., LLC v. Acuity (04/26/18): Supreme Court of Kentucky Supreme Court Holds Faulty Workmanship is Not an Occurrence.

This declaratory-judgment action arises out of a property damage claim resulting from construction defects during the renovation of the insured's basement. Martin Elias/Properties, LLC ("MEP") purchased an old home to renovate and resell for a profit. After completing renovations on the first, second, and third floors, MEP hired Tony Gosney to renovate and expand the basement.

While performing his work on the home, Gosney failed to support the existing foundation adequately before digging around it. Within days, the old foundation began to crack and eventually the entire structure began to sag. At this point, Gosney stopped work and notified his CGL insurer, Acuity.

Acuity recommended that MEP hire a structural engineer to evaluate the condition of the structure. MEP's structural engineer reported that the entire structure was at risk of imminent collapse and that substantial work was required to repair the damage caused by Gosney's work. After learning this, MEP made a demand for payment upon both Gosney and Acuity, but they rejected the demand. MEP then sued Gosney and Acuity in circuit court. Against Gosney, MEP claimed negligence, breach of contract, and breach of warranties. Against Acuity, MEP asserted bad faith by failing to provide coverage under its CGL policy. Gosney sought bankruptcy protection and disappeared. Efforts to locate Gosney failed, and he neither testified at trial nor participated in any way.

Acuity issued a CGL policy to Gosney, which provided that Acuity would pay for property damage if it resulted from an "occurrence." The policy defined occurrence as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The policy did not define the term accident.

MEP and Acuity filed motions for summary judgment based on the same policy language. MEP argued that the damage to the property from Gosney's work should be considered an accident triggering coverage under the CGL policy issued by Acuity. Acuity argued that the structural damage was caused by Gosney's faulty workmanship, which failed to qualify as an occurrence under the CGL policy, and therefore, the loss was not covered by Gosney's policy.

The trial court ruled that MEP could not recover from Acuity for the damage to the basement because that damage directly resulted from the faulty work Gosney performed, thus not satisfying the requirement of an occurrence under the CGL policy. However, the trial court ruled that MEP could recover from Acuity for the damage to the structure above the basement level, reasoning that the damage to the structure above the basement was an unexpected and unintended consequence of Gosney's faulty work on the basement, making that portion of the total loss an occurrence covered by the policy.

After the issue of damages was tried before a jury and a judgment consistent with the liability ruling was issued, Acuity appealed. The Court of Appeals, in reversing the trial court judgment, focused on Gosney's intent and control over the work and held that none of the structural damage qualified as an accident triggering coverage as an occurrence under Acuity's CGL policy.

The Kentucky Supreme Court began its analysis by reviewing its prior decisions examining the term accident as contained in CGL policies. The Court held that to determine whether an event constitutes an accident so as to afford the insured CGL policy coverage, courts must analyze the issue according to the doctrine of fortuity: 1) whether the insured intended the event to occur; and 2) whether the event was a " 'chance event' beyond the control of the insured." If the insured did not intend the event or result to occur, and the event or result that occurred was a chance event beyond the control of the insured, then CGL coverage covering accidents will apply to the benefit of the insured.

Gosney's failure to support the existing structure before digging around the old foundation resulted in cracking of the original foundation that led to near destruction of the entire structure. MEP argued, that at the very least, the damage done to the property above the basement should trigger coverage as an accident. MEP attempted to rely on a general rule in Kentucky that "a CGL policy would apply if the faulty workmanship caused bodily injury or property damage to something other than the insured's allegedly faulty work product." The Court determined that the facts of this matter did not provide an opportunity to adopt such a rule because the assertion of damages is to MEP's property alone.

In its most recent decision analyzing the term accident, the Court held that the resulting damage to the home was not of an accidental nature creating a fortuitous event, but rather an unintended consequence of poor workmanship. In that case, the damage alleged to have been done by the homebuilders was the result of poor workmanship on parts of the home on which they had directly worked or of which they had direct control. Turning to this case, the Court noted that although Gosney's work was to be done in the basement, his poor workmanship resulted in damage throughout the entire property, making it structurally unsound.

Next, the Court looked with approval to a federal district court decision involving similar facts and policy language. In the federal case, a contractor subcontracted the construction of the footer and basement for a property. The plaintiffs experienced several problems related to the settlement of the house. The damages, caused by the failure of the foundation system to support the house, included cracking to the exterior brick and mortar, the interior dry wall, and the basement floor. The federal court ruled that there was no accident because the contractor fully complied with its planned work and therefore, did not trigger an occurrence under the CGL.

In this case, Gosney had both intent and full control when conducting his work, which ultimately failed to support the existing structure. As such, the Court reasoned that it cannot be said that the resulting damage from Gosney's poor workmanship was a fortuitous event.

The Court noted that damage that results from poor workmanship would be considered an accident in laymen's terms. One would not purposefully perform substandard work for the purpose of damaging property. Accordingly, the Court focused its analysis not on whether the damage done is the type of damage that would be expected by the contractor, but rather whether the damage resulted from the actions purposefully taken by the contractor or those working under the contractor's control.

Because the actions taken by Gosney, which led to the property damage, were entirely under his control, and he fully intended to execute the plan as he did, the resulting damage throughout the property cannot be said to be an accident. As none of the structural damage qualified as an accident triggering coverage as an occurrence under Acuity's CGL policy, the Court affirmed the decision of the Court of Appeals granting Acuity's motion for summary judgment.

Brian F. Mark
Hurwitz & Fine, P.C.

Massachusetts

Bad Faith

***Scottsdale Ins. Co. v. Byrne*, No. 1:16-cv-11435-FDS (D. Mass. May 2, 2018).**

Summary: The Massachusetts federal district court allowed Scottsdale's motion for reconsideration and determined that even though Scottsdale incorrectly denied its duty to defend the insured in the underlying action, it did not act in bad faith. The court capped defendants' damages at the $3 million policy limit plus post-judgment interest from the date of judgment in the underlying action.

Scottsdale moved for reconsideration of the court's prior decision (*Scottsdale Ins. Co. v. Byrne*, No. 1:16-cv-11435-FDS (D. Mass. Mar. 1, 2018)), arguing that the court failed to address the substance of the defendants' bad faith claims and therefore judgment cannot issue. The court allowed Scottsdale's motion for reconsideration and determined that Scottsdale did not act in bad faith.

The court noted that in their summary judgment briefs, the parties agreed that the disposition of the bad-faith claims turned on whether the plaintiff's conduct in denying a duty to defend and subsequent refusal to pay on the policy was based on a "reasonable or plausible interpretation of the policy." The court determined that Scottsdale's interpretation of the exclusions was ultimately incorrect, but was not unreasonable.

The court also rejected defendants' motion for entry of judgment requiring Scottsdale to pay the entire amount of the judgment in the underlying action ($5,005,422.12) plus post-judgment interest. Defendants argued that "the general rule under Massachusetts law is that if the insurer fails to defend the lawsuit, it is liable for all defense costs and (assuming policy coverage) the entire resulting judgment or settlement, unless liability can be allocated among covered and uncovered claims" and claimed that liability could not be allocated between covered and uncovered claims.

The court determined that, as a general proposition, "[w]hen an insurer breaches its duty to defend, the insured is entitled to contract damages." According to the court, if the insurer's refusal to defend was made in "good faith," as Scottsdale's was, "there is no reason not to apply normal contract principles." Consequently, the court capped defendants' damages to the $3 million policy limit, plus post-judgment interest at the statutory rate dating from November 25, 2015, the date of judgment in the underlying action.

Suzanne M. Whitehead
Zelle McDonough & Cohen LLP
Boston, MA

Bad Faith

In *Dworska v. Forney*, Civil Action No. 1679CV0149, Massachusetts Superior Court (4/9/18), the court considered an insurer's motion to dismiss plaintiffs' Chapter 93A/176D "bad faith" claims in a wrongful death action on an issue of first impression in Massachusetts: Under the Standard Massachusetts Automobile Insurance Policy, can the insurer lawfully condition payment of the policy limits on the release of claims against a defendant driver who was neither the policyholder nor a member of the policyholder's household named on the declarations page of the policy, but was allegedly operating the vehicle with the policyholder's implied consent and therefore covered under the policy?

The Court answered in the affirmative. Because the policyholder paid premiums for indemnification and defense for himself, specified operators, and permitted users of the insured vehicle, and because the duty to defend extends to a permitted driver (even though not named on the policy), the carrier has an obligation to seek a release on the operator's behalf as a condition of settlement. The carrier's requirement that the plaintiffs release him prior to paying the policy limits was therefore not in bad faith.

The Court went further: [E]ven if I am in error in construing [the carrier's] duties under the policy, [the carrier] did not violate G.L. c. 93A and G.L. c. 176D on the facts presented. If an insurance company has a reasonable and good faith belief that it is acting appropriately, and there is no clear, applicable precedent that would inform the company that it is in error, then the company's action, even if ultimately held to be based on a misinterpretation of the law, would not be an unfair settlement practice" (citations omitted).

David Zizik
Sulloway & Hollis, PLLC

E&O / "Professional Services"

A federal district court ruled in *Barron v. NCMIC Ins. Co.*, 2018 U.S. Dist. LEXIS 75512 (D. Mass. May 4, 2018), that chiropractors were not entitled to E&O coverage related to allegations that they engaged in various fraudulent schemes in an effort to obtain higher payments from

GEICO under Massachusetts' No-Fault Personal Injury Protection (PIP) statute. Although the underlying action did contain allegations that the insured chiropractors were negligent in their treatment of patients, the court emphasized that the suit did not allege that this mistreatment caused injury to any particular individual, nor was any relief sought by GEICO for such injuries.

Michael Aylward
Morrison Mahoney

First Party / "Innocent Co-Insureds"

A federal district court has refused to enforce an intentional acts exclusion in a first-party insurance policy to an innocent co-insured even though the exclusion in question expressly stated that it applied even if "you did not commit or conspire to commit the act causing the loss." In *Shepperson v. Metropolitan Property & Cas. Co.*, No. 16-12116 (D. Mass. May 22, 2018), Judge Woodlock declared that the child who torched the insured's home was a member of her household and therefore an insured subject to the exclusion. Nevertheless, the court declared that the exclusion was unenforceable as imposing limitations to coverage beyond what is permitted by G.L. c. 175 §99.

Michael Aylward
Morrison Mahoney

Intervention / Uninsured Motorist

Krzykalski v. Tindall, New Jersey Supreme Court (04/17/18): New Jersey's High Court Rejects Rule Suggested by Plaintiffs' Bar, Holds That Uninsured Motorist Carriers Are Not Required to Intervene In "Phantom Vehicle" Cases.

This case arises out of a car accident in Florence Township, New Jersey. The car driven by plaintiff Mark Krzykalski was in the left lane traveling north, and the car driven by defendant David Tindall was directly behind plaintiff's car. As the left-lane traffic proceeded through an intersection, a vehicle in the right lane driven by an unknown John Doe unexpectedly made a left turn, cutting off the cars in the left lane. Plaintiff was able to stop his car without striking the vehicle in front of him. Defendant, however, was unable to stop in time and rear-ended plaintiff's vehicle.

Plaintiff was never able to identify the driver of the vehicle that cut him off. That vehicle was a "phantom vehicle," a vehicle that was known to be involved in an automobile accident but never sufficiently identified as to permit the owner or operator to be hauled into court.

Plaintiff suffered serious injuries in the accident and filed an uninsured motorist ("UM") claim against his automobile insurance carrier. Plaintiff sued defendant and John Doe for negligence. In defendant's answer, he asserted third-party negligence as a defense, included cross-claims for indemnity and contribution from any co-defendants, and demanded fault allocation against any defendants that might settle before trial.

The UM carrier chose not to intervene in the lawsuit. At the conclusion of the trial, over plaintiff's objection, the trial court included John Doe on the verdict sheet and instructed the jury to allocate fault between defendant and John Doe in the event that both parties were found negligent. The jury found defendant three percent negligent and John Doe ninety-seven percent negligent. Ultimately, the jury awarded plaintiff $107,890 in damages. As such, defendant was order to pay $3,200. The Appellate Division affirmed and Plaintiff appealed to the New Jersey Supreme Court.

On appeal, the New Jersey Supreme Court addressed whether a jury should be asked to apportion fault between a named party defendant and a known but unidentified defendant ("John Doe"). It further addressed whether the plaintiff's UM carrier must intervene in that action.

The New Jersey Supreme Court held that:

> parties known to be at least in part liable should be allocated their share of the fault, even when unidentified. In such cases, known but unidentified parties may be allocated fault even though recovery against those parties will be possible only through the plaintiff's UM coverage.

The court reasoned that John Doe was the operator of a motor vehicle involved in plaintiff's accident, who cannot be identified. By requiring that automobile insurance policies include UM coverage, the New Jersey Legislature has acknowledged and prepared for precisely such circumstances. Stated simply, "phantom vehicles" driven by known but unidentified motorists that play a part in an accident presumptively may be allocated fault in accordance with New Jersey's joint tortfeasors statutes and comparative negligence statutes.

The New Jersey Association for Justice (plaintiffs' bar) filed an amicus brief, arguing that the New Jersey Supreme Court should adopt a bright-line ruling requiring joinder of a plaintiff's UM carrier in motor vehicle cases where there is a known and identified defendant driver and a phantom vehicle. The Court rejected this.

The New Jersey Supreme Court held that the UM carrier who will ultimately cover any damages attributed to "phan-

tom vehicles" is not required to intervene and become a party to the negligence suit. In this case, plaintiff's UM carrier received notice of the litigation and had the option to intervene and participate at trial in an effort to limit its exposure. The Court held that there was no reason to require the UM carrier's participation where it chose not to do so.

John R. Ewell
Hurwitz & Fine, P.C.

New York

Environmental / Allocation / Non-Cumulation Clauses

On remand from the Second Circuit's ruling that *Viking Pump* required an insured be permitted to obtain coverage for its environmental liabilities from excess insurers on an "all sums" basis, Judge Rakoff ruled in *Olin Corp. v. Certain Underwriters at Lloyd's*, No. 84-1968 (S.D.N.Y. April 18, 2018) that Olin shall receive $55 million from the excess insurer (Lamorak) as Lamorak is only entitled to a set off of about $2.66 million for earlier global settlements that Olin negotiated with its other insurers. As those settlements were not broken down on a site-by-site basis, the court ruled that the amounts allocable to the "prior insurance" subject to Lamorak's non-cumulation clause must be calculated on a *pro tanto* basis taking into account the total number of sites at issue. Judge Rakoff also granted summary judgment to London based on a judgment reduction clause in its prior settlement that required Olin to protect it in the event of contribution claims against it by other insurers.

Michael Aylward
Morrison Mahoney

9/11 Litigation / Pollution Exclusion

National Union Fire Ins. Co. of Pittsburgh, PA v. Burlington Ins., Supreme Court, New York County (4/23/18): Carrier Must Defend 9/11 Litigation; Unclear Whether Pollution Exclusion Would Apply to All Claims.

This decision arises out of post-9/11 litigation. Burlington issued a commercial general liability policy to Mayore Estates, LLC ("Mayore"). Mayore owned a 34-story building in lower Manhattan. Mayore was named in certain personal injury actions resulting from clean-up work performed at its property following the disaster on September 11, 2001.

The World Trade Center litigation was consolidated before the Southern District of New York. In September 2005, Burlington received a copy of the Master Complaint in the federal court action, which alleged injuries to a plaintiff class relating to post-9/11 clean-up activities. The Master Complaint alleged that plaintiffs sustained injuries at both the trade center and at surrounding buildings identified in "Check-Off Complaints." Mayore was identified in 51 Check-Off Complaints.

Burlington disclaimed any duty to defend or indemnify Mayore on the basis of a pollution exclusion. As a result, National Union, who issued the excess policy, stepped down and provided a defense. Ultimately, National Union brought this action to recoup certain amounts it paid in the defense of Mayore and to settle claims.

Burlington moved for summary judgment in this action. The central dispute was the scope of the Total Pollution Exclusion and whether the dispersal of toxins and other matter as a result of the World Trade Center disaster constitutes pollution within the meaning of that exclusion. Citing to the Court of Appeals decision *Belt Painting Corp. v. TIG Insurance Co.*, the parties were generally in agreement that this type of exclusion would apply to "traditional" or "classic" environmental pollution. They disagreed as to whether the World Trade Center dispersal constituted such pollution. In *Belt*, the Court of Appeals concluded the exclusion was ambiguous and did not apply to injuries caused by the inhalation of paint fumes in an office the insured was painting and stripping. The court noted however, that in *Belt* the Court of Appeals was not called upon to, and did not, articulate comprehensive criteria for determining whether pollution qualifies as classic or traditional environmental pollution for purposes of insurance policy exclusions.

The court reasoned that while the attack on the World Trade Center may have resulted in an environmental disaster, and while the World Trade Center emissions contained materials that would undoubtedly qualify as environmental pollutants, the event that resulted in their dispersal was unprecedented. It also pointed to allegations in the complaints concerning violations of the labor law and claimed failures to provide proper safety equipment. In response, Burlington had argued essentially that it was irrelevant how the allegations were pled since none of the damage would have occurred but for the pollutants. Despite this argument, the court concluded that given the extensive allegations of lack of workplace safety, and consistent with its decisions on this issue, Burlington did not meet its heavy burden that the dispersal of pollutants, standing alone, caused the plaintiffs' injuries. Accordingly, it found that Burlington had a duty to defend, but trial issues of fact existed as to the extent to which National Union was entitled to indemnity.

The court then considered Burlington's secondary argument that the asbestos exclusion applied. Consistent with its discussion of the population exclusion, the court held that Burlington likewise failed to show that all of the plaintiffs' injuries were within that exclusion.

Next, the court considered the argument that the occurrences did not fall within the Burlington policy period, since it went into effect a month after 9/11. In rejecting any such argument, the court pointed to allegations in the Master complaint that plaintiffs ingested and breathed the harmful toxins during the entire time of the cleanup.

Lastly, the court dismissed an argument by Burlington that it wasn't provided proper notice of 21 of the 51 Check-Off Complaints. The court pointed to the contents of Burlington's coverage letters in which they acknowledge the contents of the Check-Off Complaints were essentially the same as those in the Mater Complaint, for which Burlington had disclaimed coverage dating back to 2005. Accordingly, in its view, any further notice to Burlington was excused as futile.

Jennifer A. Ehman
Hurwitz & Fine, P.C.

Declaratory Relief/Standing

The Appellate Division ruled in *Preferred Contractors Insurance Company Risk Retention Group LLC v. Nuway Interior Corp.*, 2015-0709730 (App. Div. May 2, 2018), that other defendants in a declaratory judgment action had not been injured by the court's entry of a default judgment as to the insureds for failing to appear or answer and therefore lacked standing to appeal that order.

Michael Aylward
Morrison Mahoney

Pennsylvania

Assault and Battery Exclusions

A federal district court has refused to require a liability insurer to cover allegations that a motel negligently allowed its premises to be used for sex trafficking. In *Nautilus Insurance Co. v. Motel Management Services Inc.*, No. 17-4491 (E.D. Pa. May 24, 2018), Judge Savage ruled that a woman's claim that was taken to the motel and forced to engage in sex acts was a claim for assault and therefore subject to a broad "assault and battery" exclusion that extended both to assaults and to allegations that the insured has failed to provide adequate security to prevent assaults. In any event, the court declared that the public policy of Pennsylvania prohibits requiring coverage for intentional or criminal acts.

Michael Aylward
Morrison Mahoney

South Carolina

Tripartite / Claims Against Defense Counsel

Answering a certified question from the federal district court, the South Carolina Supreme Court held that an insurer may maintain a direct malpractice action against counsel hired to represent the insured where the insurance company had a duty to defend. Sentry Select Insurance Company (Sentry) hired Roy P. Maybank (Maybank) of the Maybank Law Firm to defend a Sentry insured in a personal injury lawsuit. Maybank failed to timely answer requests to admit, and Sentry claimed that as a result of Maybank's negligence it had to settle the case for $900,000 when Maybank had previously represented to Sentry that the case could be settled in the range of $75,000 to $125,000. The Supreme Court held that "an insurer may bring a direct malpractice action against counsel hired to represent its insured. However, we will not place an attorney in a conflict between his client's interests and the interests of the insurer. Thus, the insurer may recover only for the attorney's breach of his duty to his client, when the insurer proves the breach is the proximate cause of damages to the insurer." The Supreme Court also noted that "[i]f the interests of the client are the slightest bit inconsistent with the insurer's interests, there can be no liability of the attorney to the insurer, for we will not permit the attorney's duty to the client to be affected by the interests of the insurance company[]" and as a final limitation on the insurer's right to bring a malpractice action against the lawyer it hired to represent the insured, "the insurer must prove its case by clear and convincing evidence." Because the Supreme Court affirmatively answered the certified question, it indicated that the federal district court should independently determine whether Maybank was negligent based on all the facts and circumstances of the case.

Charles W. Browning
Elaine M. Pohl
Patrick E. Winters
Plunkett Cooney

Washington

First Party / Fortuity

A Washington federal district court ruled in *Market Place North Condominium Association v. Affiliated FM Insurance Company*, 2018 U.S. Dist. LEXIS 76724 (W.D. Wash. May 7, 2018), that an "all risk" property insurance policy did not provide coverage for mold and water damage to a homeowners to the outdoor deck of a condominium where the insured was already aware of this damage. Under the circumstances, the district court declined to find that this loss was fortuitous.

Michael Aylward
Morrison Mahoney

"Occurrence" / Negligent Supervision Claims

In *Tulley v. Mustafa*, 2018 WI 47 (Wis. May 11, 2018), a sharply divided Wisconsin Supreme Court ruled that a CGL policy does not cover allegations of negligent supervision when a negligent supervision claim rests solely on an employee's intentional act of assault and battery; without any separate basis for a negligence claim against the employer, no coverage exists. In reversing the decision of the Court of Appeals, the majority held that coverage could not be based upon the employer's failure to tell his employees not to punch employees in the face and that coverage would only arise in such cases if the employer's own acts were found to have accidentally caused the plaintiff's injuries. Writing in dissent, Justice Bradley (joined by Justices Abrahamson and Kelly) argued that the majority had erred in not considering the meaning of "accidental" from the standpoint of the employer and that the majority had improperly concluded that coverage would not apply because no jury would award damages on the theory that an employer had a duty to instruct employees not to punch customers. Justice Kelly filed a separate dissent, echoing Justice Bradley and insinuating that the majority had seized this case as an excuse to eliminate coverage for negligent supervision claims.

Michael Aylward
Morrison Mahoney