



WHAT EVERY CONSTRUCTION PROFESSIONAL SHOULD KNOW

Insurance coverage rights will be important to every construction professional at some point; knowledge of these basic principles will prove essential.

ABOUT INSURANCE COVERAGE

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Every construction professional will at some point be in a situation where insurance rights are of paramount importance to the parties. Many cases involving insurance are shaped by actions that have been taken or decisions made long before anyone has filed a suit or tendered a claim. Therefore, it is essential that all construction professionals be familiar with some basic rules of insurance coverage. What follows is a primer on some of the most important coverage principles to be aware of, even if you, as a construction professional, do not consider yourself a coverage expert, do not want to be a coverage expert, and/or expect that a more seasoned coverage expert will become involved.

Pre-tender defense costs likely are not covered

Claims made against an insured that might be covered by an insurance policy should be tendered to the carrier as early as possible. It is important to tender early because virtually every state holds that pre-tender defense costs are not covered.¹ Since primary policies generally state that a carrier has a right and duty to defend the case, courts have understandably concluded that a carrier cannot be held responsible for breaching that duty before the policyholder asks it to undertake the defense. For this reason, claims for pre-tender defense costs are almost always denied, and tendering early will minimize those costs. Tendering is not a complicated process. Where a claim involves a complicated coverage issue, the

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insured may wish to provide a more detailed legal and factual analysis to enable the carrier to find coverage. In the typical case, especially where the insured and carrier have had a long standing relationship, tendering requires nothing more than a two-sentence letter to the carrier enclosing a copy of the complaint and asking the carrier to defend.

Pre-tender settlement or judgment costs may be covered

The issue is more complicated regarding judgment or settlement obligations incurred by the policyholder before tendering to the carrier. For instance, what if the insured, assuming that its liability will be within its self-insured retention, fails to tender the matter to the carrier, only to have the jury verdict returned in excess of the retention? As stated above, the policy holder will not be able to recover its defense costs. With respect to the amount of the judgment above the retention, the courts follow three approaches.² First, a small minority of courts hold that late notice absolutely bars the recovery of pre-tender settlement or judgment costs.³ A second minority of courts require that the policyholder show that the carrier was not prejudiced by the late notice before it can recover (i.e., the policyholder has the burden of proof).⁴ The majority of courts, however, follow the "notice-prejudice rule," whereby the policyholder will be entitled to reimbursement for pre-tender settlement and judgment costs, unless the carrier proves it was prejudiced by the lateness of the notice (i.e., the carrier has the burden of proof).⁵

The duty to defend is extremely broad

Virtually all Comprehensive General Liability (CGL) primary policies impose a duty to defend on the carrier, pursuant to which the carrier agrees that it "will have the right and duty to defend any suit seeking damages for bodily injury or property damage to which [its] insurance applies," or similar language. This is separate from the duty to indemnify (i.e., duty to pay settlement costs or judgments). Most courts hold that the duty to defend is extremely broad, broader than the duty to indemnify.⁶ The

duty to defend includes the duty to defend groundless claims, false claims, fraudulent claims, allegations of intentional torts, allegations of willful acts, and allegations of criminal conduct, so long as there is some claim that, if true, taking the plaintiff's allegations at their face value, would even potentially provide any basis for coverage.⁷ For example, the California Supreme Court has held that the carrier must defend a suit that potentially seeks damages within the coverage of the policy.⁸ Most courts will hold that the defense is excused only where "the third party complaint can by no conceivable theory raise a single issue which could bring it within the policy coverage."⁹

The insurer's duty to defend is based on the allegations in the third party complaint,¹⁰ or in some courts, on any facts known to the insurer from any source.¹¹ The duty to defend arises when the insured tenders the defense of the suit, and does not end until the underlying suit is concluded, the facts show that there is absolutely no potential for coverage, or the policy limits have been exhausted.¹²

Duty to indemnify is less broad

Just because a duty to defend exists does not mean that the ultimate judgment will be covered under a policy. Whereas the duty to defend is triggered by the "potential" that a claim is covered, the duty to indemnify is triggered by the actual judgment. For example, if the plaintiff sues an insured and alleges a cause of action for negligence and fraud, there will be a duty to defend because, though fraud is not covered, negligence generally is. Because there is a potential that an eventual judgment will be based on a negligence claim, the duty to defend is triggered. If the jury's verdict ultimately is based on the fraud claim, and not the negligence claim, however, there will be no duty to indemnify the insured for the judgment costs, even though the carrier did have a duty to defend the case.¹³

No such thing as "litigation insurance"

Although many people assume that they will always have insurance coverage if they are sued, there is no such thing as "litigation insurance." In general, liability insur-



OCCURRENCE-BASED POLICIES CAN BE TRIGGERED DECADES AFTER THE EXPIRATION OF THE POLICY.

ance policies cover personal injuries and property damage. If no one was hurt and no property was damaged, there usually will be no coverage. For example, claims for breach of contract, construction delays, failure to comply with building codes or architectural drawings and similar causes of action generally are not covered under most policies. Moreover, any harm caused intentionally will not likely be covered.¹⁴

Claims-based policies and occurrence-based policies cover different things

Most insurance policies are either "claims-based" or "occurrence-based." These two different kinds of policies focus on two different time periods to determine whether they cover a particular claim. Claims-based policies come in various forms, but generally cover claims made during the policy period, regardless of when the injury or damage occurred. For example, if the insured receives a demand letter or is served with the complaint during the policy period, the claims-based policy will cover it, even if the allegations are based on acts or injuries that occurred years before.

Conversely, occurrence-based policies have nothing to do with when the lawsuit is filed or the demand letter is sent, but rather focus on when the injury "occurred," and cover claims that arise from injuries that occur during the policy period. Most policies define an occurrence as when property damage or personal injury takes place. This gets even more complicated with "long tail" or "continuous trigger" types of injuries, such as asbestos premises-liability cases, soil subsidence cases, or environmental cases, or other cases where the injury occurred over a long period of time. Where the injury, such as an automobile accident, an explosion, or a slip-and-fall, occurs at a finite moment, the injury obviously occurred when that finite event took place. But what about when someone breathes in asbestos in 1950 and files a premises liability case today? What about a home built on landfill that slowly moves a minute amount each day until the foundation is compromised? What about the case where someone accidentally tips over a bucket of TCE in 1975, it leaches through the soil until 1990 when it hits the water supply, and

then is discovered years later? In these three situations, the courts have held that all of the policies from the initial onset of the injury (the inhalation of asbestos, the initial movement of the soil, the initial dispersal of TCE) until the time of suit are "triggered," and thus each occurrence-based policy may provide coverage.¹⁵

There are advantages and disadvantages to both types of policies. Claims-based policies, which are much more popular today, at least from the insurers' standpoint, are usually cheaper. They can be purchased for less because, at the end of the claims period, the insurer knows that there will be no more claims and thus there is certainty. Claims-based policies can also provide retroactive coverage (unless there is an exclusion for known acts), and so can be useful for filling coverage gaps after the fact. On the other hand, these policies provide no prospective coverage. Once the policy period is over, there is no coverage for injuries arising out of acts the insured performed during the period.

Occurrence-based policies, on the other hand, can be triggered decades after the expiration of the policy. In fact, due to asbestos and environmental exclusions in most policies these days, the only policies providing coverage today in the asbestos and environmental arenas are occurrence-based policies. In situations involving soil movement or latent construction defects, where the property damage may not manifest itself or be discovered until years after it first occurs, an occurrence-based policy whose period has ended may still afford coverage. Unlike claims-based policies, occurrence-based policies provide no retroactive coverage but virtually infinite prospective coverage.

You don't need possession of the policy to have coverage

Surprisingly, one does not have to have possession of an insurance policy in order to be covered by it. As discussed above, older policies are often triggered many years after the injury occurred, and those policies may have been lost, destroyed or otherwise misplaced. Fortunately for insureds, there will still be coverage under the "lost policies doctrine" if the policy

has been lost or destroyed without fraudulent intent on the part of the insured, and if the insured can prove "(1) the fact that he or she was insured under the lost policy during the period in issue, and (2) the substance of each policy provision essential to the claim for relief, i.e., essential to the particular coverage that the insured claims."¹⁶

Don't forget about choice-of-law analysis

Just because a lawsuit is filed in a particular jurisdiction does not mean that the jurisdiction's own law will apply. An insured or insurer in a declaratory relief action will often file in a particular state because it believes that state's law suits its interests best; however, that state is not obligated to apply its own forum's law simply because an action is initially filed there. Though the courts in different states use different standards for determining which state's law to apply to the substantive issues before them, most of these standards will include the following factors: the location of the injury, the location of the conduct giving rise to the injury, where the policy was negotiated, drafted and/or executed, and the location of the insured and the insurer.¹⁷ In other words, if, for example, an insurer and an insured both based in other states are litigating an action in California involving underlying injuries also taking place out-

side of California, it is unlikely that California law would apply, and either party is at liberty to request that the court apply the law of another state more intimately involved with the transaction and more favorable to that party.¹⁸

Successors are not always covered

Most states hold that corporate successors (who, for example, purchase a division or product) are liable for the acts of their predecessors if the successor (1) is a continuation of the old business, (2) has essentially the same stockholders, directors, employees, or (3) continues to carry on the same business.¹⁹ In the insurance context, this gets more complicated. What if the liability arose out of an acquisition of property that took place after the policy period? The majority rule is that there will be no coverage that would impose upon the carrier liability for entities, assets and acquisitions that did not exist at the time of the policy period.²⁰

Problems can also surface where an acquired entity's liabilities arose before the acquisition. For example, if product line A caused an asbestos-related disease in the plaintiff in 1960 and that product line was purchased in 1980 by the successor, what happens to the policy for product line A in effect in 1970? Although most courts will hold that, since liabilities follow assets, the insurance policy is an asset and will follow

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the acquisition,²¹ some courts will hold that there is no coverage unless the carrier consented to the acquisition, which of course no carrier will have an incentive to do.²²

For coverage, there has to be a "suit"—usually

Most policies require that the carrier defend "any suit against the insured."²³ Until recently, many assumed that this language meant that carriers had to defend any case where a demand letter is sent, or any case that proceeded in front of any judicial or quasi-judicial panel (such as EPA actions, regulatory actions, binding arbitration). In 1998, the California Supreme Court ruled that carriers only had to defend suits filed in an actual trial court whether it be a state court or federal.²⁴ This analysis further extends to a carrier's duty to pay for settlements. One example is the case where the insured pays a settlement before an action has been filed. Since there has been no "suit" filed, and thus no damages as a

result of a suit, the carrier likely does not have to pay for the settlement. For this reason, the insured must ensure that the carrier has approved any settlement in a pre-suit context, because the insured may lose its coverage if the carrier later objects on the grounds that there was no suit involved.

The number of "occurrences" matters

In some cases, one event or course of conduct injures a number of different people or causes damage to a number of different items. For example, an environmental discharge can cause property damage to the water supply, while also causing 20 children to contract leukemia. In this situation, it is unclear whether there are one, two, 20 or some other number of occurrences. Moreover, if the foundation for each home in a 100-home real estate development is constructed the same way, and 30 of the homes experience foundation problems and need substantial repairs, there may be one occurrence or 30.

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The resolution of these questions is important because most policies provide a limit of liability for each occurrence, and most policies also provide a deductible or self-insured retention for each occurrence. More occurrences equal more policy limits, but also more deductibles. If each flawed foundation in that construction project is a separate occurrence, there will be thirty separate limits of liability, but also 30 separate deductibles. The Second Circuit recently addressed this issue in *World Trade Center Properties, L.L.C. v. Hartford Fire Insurance Co.*²⁵ The court devoted five pages to a discussion of whether the terrorist attacks of September 11, 2001 on the World Trade Center's two towers constituted one occurrence (i.e., as a result of one concerted attack) or two; if the damage arose out of one occurrence the buildings' owner would be able to recover only half as much from its insurers as it would if the attacks were considered two separate occurrences, but there would also be only one deductible.

In most cases, courts hold that if the injuries, no matter how many they may be, are caused by one event or course of conduct, they will constitute one occurrence for insurance purposes.²⁶ Because of the substantial effect on coverage, insureds and insurers must perform an analysis to determine whether there is one occurrence or more than one. As shown by *World Trade Center*, this is not always clear. Several minor occurrences, each with a separate deductible, may mean that there is ultimately no coverage whatsoever. On the other hand, several minor injuries that constitute one major occurrence with a low per-occurrence limit may mean that all of the coverage is exhausted quickly.

Conclusion

Insurance coverage issues can come up at various stages both indirectly and directly related to litigation: from choosing the type of policy to determining its coverage of a successor, from deciding where to file suit to tendering a claim. It is crucial that anyone in the construction industry be aware

of these issues to ensure that his or her rights are protected at all times. ■

NOTES

¹ Whether pre-tender settlement or judgment costs are covered is a more complicated question, as discussed below.

² See generally Charles C. Marvel, LL.B., Modern Status of Rules Requiring Liability Insurer to Show Prejudice to Escape Liability Because of Insureds' Failure or Delay in Giving Notice of Accident or Claim, or in Forwarding Suit Papers, 32 A.L.R. 4th 141.

³ See, e.g., *Continental Cas. Co. v. Cuda*, 306 Ill. App. 3d 340 (1999).

⁴ See, e.g., *Allstate Ins. Co. v. Kepchar*, 592 N.E. 2d 694 (Ind. App. 1992). A few courts have held that a policyholder's showing that the carrier was not prejudiced is not conclusive on the timeliness of notice, but is a factor in determining whether the notice was reasonable. See, e.g., *U.S. Fidelity & Guar. Co. v. Maren Eng. Corp.*, 403 N.E. 2d 508 (1980).

⁵ See, e.g., *Newcap Ins. Co. v. Employers Reinsurance Corp.*, 295 F. Supp. 2d 1229 (D. Kan. 2003) (applying Kansas law).

⁶ See, e.g., *Gray v. Zurich*, 65 Cal. 2d 263 (1966).

⁷ See, e.g., *Prahn v. Rupp Const. Co.*, 277 N.W.2d 389 (Minn. 1979).

⁸ *Gray*, 65 Cal. 2d. at 275.

⁹ *Id.*

¹⁰ See, e.g., *U.S. Fidelity & Guar. Co. v. Wilkin Insulation Co.*, 578 N.E. 2d 926 (Ill. 1991); *Sterilite Corp. v. Continental Cas. Co.*, 458 N.E. 2d 338 (Mass. App. 1983).

¹¹ See, e.g., *Horace Mann Ins. Co. v. Barbara B.*, 4 Cal. 4th 1076 (Cal. 1993).

¹² See, e.g., *Montrose v. Superior Court* ("Montrose I"), 6 Cal. 4th 287, 295 (1983).

¹³ See, e.g., *Palmer v. Truck Ins. Exchange*, 21 Cal. 4th 1109, 1120 (1999); *Farmers Texas County Mutual Ins. Co. v. Griffin*, 955 S.W. 2d 81, 82 (Tex. 1997); *Sevidone Const. Corp. v. Security Ins. Co. of Hartford*, 477 N.E. 2d 441, 444 (N.Y. 1985).

¹⁴ Intentional acts will generally not be covered where the policy provides coverage for "accidents." See, e.g., *CU Lloyd's of Texas v. Main Street Homes, Inc.*, 79 S.W. 3d 687 (Tex. App. 2002).

¹⁵ See, e.g., *Atchison, Topeka & Santa Fe Railway Co. v. Stonewall Ins. Co.*, 71 P.3d 1097 (Kan. 2003); *Quincy Mut. Fire Ins. Co. v. Borough of Bellmawr*, 799 A.2d 499 (N.J. 2002); *Montrose Chem. Corp. v. Admiral Ins. Co.* ("Montrose II"), 10 Cal. 4th 645 (1995).

¹⁶ *Dart Indus., Inc. v. Commercial Union Ins. Co.*, 28 Cal. 4th 1959, 1071 (2002).

¹⁷ Restatement (Second) of Conflict of Laws, §§ 188, 193; see also, *Allstate Ins. Co. v. Occidental Int'l, Inc.*, 140 F.3d 1 (1st Cir. 1998); *Interface Flooring Systems, Inc. v. Aetna Cas. & Surety Co.*, 804 A.2d 201 (Conn. 2002); *Clark v. TAP Pharmaceutical Prod., Inc.*, 343 Ill. App. 3d 538 (2003). California applies a "governmental interest" analysis, considering the respective interests, including public policies, of the states whose law might be applied, and when more than one state has an interest in applying its law, compares the relative degree to which each state's interest would be impaired by applying another state's law. *Dixon Mobile Homes, Inc. v. Walters*, 48 Cal. App. 3d 964, 972 (1975); *Offshore Rental Co., Inc. v. Continental Oil Co.*, 22 Cal. 3d 157, 164-66 (1978).

¹⁸ See, e.g., *Hurtado v. Superior Court*, 11 Cal. 3d 574 (1974), see also Restatement (Second) of Conflict of Laws, § 136.

¹⁹ See, e.g., *Beatrice v. State Bd. of Equalization*, 6 Cal. 4th 767 (1993).

²⁰ See, e.g., *A. C. Label Co. v. Transamerica Ins. Co.*, 48 Cal. App. 4th 1188 (1996).

²¹ See, e.g., *Gopher Oil Co. v. American Hardware Mut. Ins. Co.*, 588 N.W. 2d 756 (Minn. App. 1999); *Imperial Enter., Inc. v. Fireman's Fund Ins. Co.*, 535 F. 2d 287 (Ga. 1976); *Total Waste Mgmt. Corp. v. Commercial Union Ins. Co.*, 857 F. Supp. 140 (D.N.H. 1994).

²² See, e.g., *Henkel Corp. v. Hartford Accident & Ind. Co.*, 29 Cal. 4th 934 (2003); *Red Arrow Prod. Co., Inc. v. Employers Ins. of Wausau*, 607 N.W. 2d 294 (Wis. App. 2000).

²³ *St. Paul Fire & Marine Ins. Co., Inc. v. McCormick & Baxter Creosoting Co.*, 870 P2d 260, 266 (Or. App. 1994).

²⁴ *Foster-Gardner, Inc. v. Nat'l Union Fire Ins. Co.*, 18 Cal. 4th 857 (1998); but see *St. Paul Fire & Marine*, 870 P2d, note 23, at 266.

²⁵ *World Trade Center Props., L.L.C. v. Hartford Fire Ins. Co.*, 345 E3d 154, 190 (2d Cir. 2003). The court did not decide whether the attacks constituted one occurrence or two, only that "a jury could find two occurrences in this case, . . . or it could find that the terrorist attack, although manifested in two separate airplane crashes, was a single, continuous, planned event causing a continuum of damage that resulted in the total destruction of the WTC, and, thus, was a single occurrence."

²⁶ See, e.g., *Norfolk Southern Corp. v. California Union Ins. Co.*, 859 So. 2d 167, 192 (La. App. 2003); *Metropolitan Life Ins. Co. v. Aetna Cas. & Surety Co.*, 765 A. 2d 891, 898-99 (Conn. 2001).