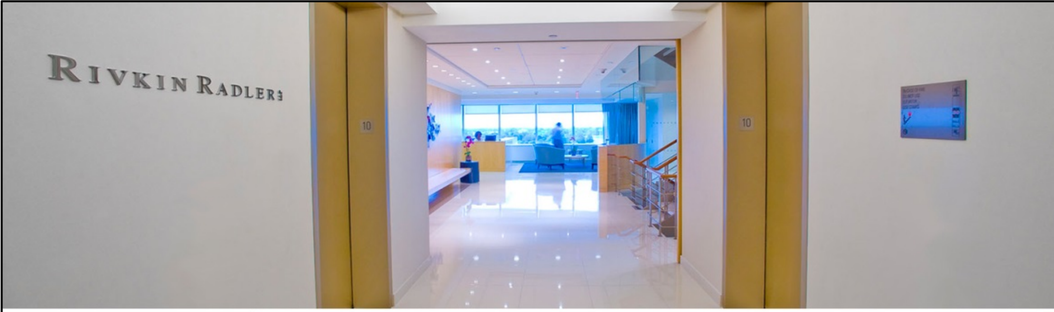

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Nevada Supreme Court Says Insurer That Has Not Acted in Bad Faith May Be Liable for Any Consequential Damages Caused By Its Breach of Duty to Defend

The Nevada Supreme Court has ruled that an insurer may be liable for any consequential damages caused by the breach of its contractual duty to defend its insured. Moreover, the court said, good faith determinations were irrelevant for determining damages following an insurer's breach of this duty.

The Case

The insurer for an auto detailing company determined that an accident involving the company's owner's truck was not covered under its insurance policy because, at the time of the accident, the owner had not been driving the truck in the course and scope of his employment.

After the insurer rejected the injured party's demand to settle within policy limits, the injured claimant sued the auto detailing company and the owner, alleging that he had been driving in the course and scope of his employment. The injured claimant notified the insurer of the suit, but the insurer refused to defend. The detailing company and its owner defaulted. The claimant, the detailing company, and the owner later reached a settlement agreement for $18,050,183. The claimant agreed not to execute on the judgment in an exchange for an assignment of rights against the insurer.

The claimant next sued the insurer. The U.S. District Court for the District of Nevada found that the insurer had not acted in bad faith, but that it had breached its duty to defend its insured.

Initially, the district court concluded that the insurer's liability for breaching its duty to defend was capped at the policy limit plus any cost incurred by the auto detailing company in mounting a defense because the insurer had not acted in bad faith. Upon reconsideration, the district court concluded that the auto detailing company was entitled to recover consequential damages that exceeded the policy limit for the insurer's breach of the duty to defend, and that the default judgment was a reasonably foreseeable result of the breach of the duty to defend. Additionally, the district court concluded that bad faith was not required to impose liability on the insurer in excess of the policy limit.

The district court nevertheless stayed the proceedings, and asked the Nevada Supreme Court to decide, "[w]hether, under Nevada law, the liability of an insurer that has breached its duty to defend, but has not acted in bad faith, is capped at the policy limit plus any costs incurred by the insured in mounting a defense, or [whether] the insurer [is] liable for all losses consequential to the insurer's breach."

The Nevada Supreme Court's Decision

The Nevada Supreme Court ruled that an insurer in the circumstances set forth in the certified question was liable "for all losses consequential to the insurer's breach."

In its decision, the court explained that the majority view is that "[w]here there is no opportunity to compromise the claim and the only wrongful act of the insurer is the refusal to defend, the liability of the insurer is ordinarily limited to the amount of the policy plus attorneys' fees and costs."

The minority view, the court added, is that damages for breach of the duty to defend are not automatically limited to the amount of the policy but that "[a] party aggrieved by an insurer's breach of its duty to defend is entitled to recover all damages naturally flowing from the breach."

The court decided that the minority view was "the better approach." Therefore, it concluded, an insurer may be liable for a judgment that exceeds the policy limit if the judgment is consequential to the insurer's breach – even in the absence of bad faith on the part of the insurer.

The case is *Century Surety Co. v. Andrew*, No. 73756 (Nev. Dec. 13, 2018).

Vermont Supreme Court Finds That False Pretense Exclusion Does Not Bar Loss Arising from Email Scam

The Vermont Supreme Court, ruling in favor of a policyholder, held that a False Pretense Exclusion in a business-owner policy did not bar a loss based on an electronic transfer of funds procured by deception because the loss was not a "physical loss or damage."

The Case

The case involved a claim for coverage under a business-owner policy arising from a transfer of money.

The policyholder's employee received an email purporting to be from his manager. The email directed the employer to transfer $19,875.00 to a specified outside bank account through an electronic-funds transfer. An unknown individual had gained control of the manager's email account and sent the "phony" email. The employee electronically transferred the money. When the policyholder learned that the manager had not sent the email, it contacted its bank, which froze its account and limited the loss to $10,261.36.

The policyholder sought coverage for the loss under the provisions of its policy covering losses due to forgery, for forged or altered instruments, and for losses resulting from computer fraud. The policyholder also claimed coverage under a provision of the policy for the loss of money or securities by theft.

The insurer denied coverage based on an exclusion in the policy for "physical loss or physical damage" caused by or resulting from false pretense that concerned "voluntary parting" of the property — the False Pretense Exclusion. Specifically, the provision excluded from coverage any "physical loss or physical damage caused by or resulting from . . . . [v]oluntarily parting with any property by you or anyone else to whom you have entrusted the property if induced to do so by any fraudulent scheme, trick, device or false pretense."

The policyholder sued its insurer. The parties filed cross-motions for summary judgment. The trial court, although finding the policy terms confusing, held that the False Pretense Exclusion was unambiguous and encompassed the policyholder's loss. The trial court relied on the fact that funds held by a bank fell within the policy's definition of "money," defined as "[c]urrency, coins and bank notes whether or not in current use." The trial court granted the insurer's motion, denied the policyholder's motion, and entered judgment for the insurer.

On appeal, the policyholder argued that False Pretense Exclusion did not apply because it only excludes "physical loss or physical damages" and the policyholder's loss was not a "physical loss."

The Vermont Supreme Court's Decision

Reversing the trial court, the Vermont Supreme Court held that reasonable people could disagree as to whether transferring money was a "physical loss or physical damage" within the meaning of the exclusion.

The Vermont Supreme Court followed the reasoning that a federal court in Montana recently applied to a nearly identical dispute involving the same insurer. In the Montana federal district court case, the court held that the False Pretense Exclusion was ambiguous because it was subject to at least two reasonable interpretations: either the covered property was required to be tangible or it wasn't.

On the one hand, the Montana federal district court acknowledged the "practical reality" that a loss of electronic funds was "essentially the same" as a loss of an equivalent amount of cash. On the other hand, the Montana federal district court noted that the False Pretense Exclusion distinguished between "loss or damage" and "physical loss or damage." Thus, the provision could reasonably be construed to require that the covered property be tangible.

The Vermont Supreme Court agreed with the Montana District Court that the False Pretense Exclusion was ambiguous because it was subject to at least two reasonable interpretations. The fact that electronic funds qualified as "money" under the policy, according to the court, did not necessarily mean that "money" can only be subject to "physical loss." It noted that other provisions of the policy distinguished between "loss of money" and "physical loss or physical damage" to money. Therefore, the court concluded that "money" was not subject solely to "physical loss."

Having found the False Pretense Exclusion inapplicable, the Vermont Supreme Court remanded the case to the trial court to determine in the first instance whether certain policy provisions provided coverage for the policyholder's losses.

The case is *Rainforest Chocolate, LLC v. Sentinel Insurance Co.*, 2018 Vt. LEXIS 240 (Vt. Sup. Ct. Dec. 28, 2018).

Water Exclusions Did Not Preclude Coverage of Water Damage Caused by Ruptured Water Main Line, Kentucky Supreme Court Decides

The Kentucky Supreme Court has ruled that water exclusions in a homeowner's insurance policy did not preclude coverage of damage to the home caused by water that entered the basement after a public utility's water main line ruptured.

The Case

A water main line owned and operated by a public utility company running near a railroad crossing on a nearby street ruptured, causing the release of large amounts of pressurized water to flow above the ground. The water ran onto a nearby property and filled the basement of a home with water six feet deep.

The homeowner sought payment from his insurer. The insurer denied the claim, asserting that some or all the following policy exclusions applied:

> (3) Water damage meaning:
>
> > (a) regardless of the cause, flood, surface water, waves, tidal water, storm surge, or overflow of a body of water. . . .
> >
> > (d) water below the surface of the ground. This includes water which exerts pressure on or flows, seeps or leaks through any part of a building, sidewalk, driveway, swimming pool or other structure.

The homeowner sued. The trial and appellate courts ruled in favor of the insurer, and the dispute reached the Kentucky Supreme Court.

The Kentucky Supreme Court's Decision

The court reversed.

In its decision, the court said that it read subsection (3)(a) of the water exclusion as excluding from coverage damage caused entirely by "natural forces." The bursting of a public water main, the court ruled, was "not a natural water phenomenon."

The court rejected the insurer's argument that the phrase "regardless of the cause" preceding the enumeration of events comprising "water damage" negated the distinction between naturally occurring versus artificially made water disasters, ruling that the phrase did not change the fact that the event nevertheless had to constitute "flood, surface water, waves, tidal water, storm surge, or overflow of a body of water" before the phrase applied.

Similarly, the court continued, the exclusion for damage caused by "surface water" did not apply in this case because the water that damaged the insured's home came from a "watercourse" – that is, a water main line – and did not constitute "surface water."

Finally, the court found, the insured did not suffer damage from "water below the surface of the ground" because the water that damaged his home was not water beneath the ground or subterranean water, but rather, was water flowing through a pipe that broke, causing the water from the pipe to flow above the surface of the ground.

The court concluded that it could not agree that the event causing damage in this case was contemplated by the policy's water exclusions.

The case is *Comley v. Auto-Owners Ins. Co.*, No. 2017-SC-000596-DG (Ky. Dec. 13, 2018).

Insurer Had No Duty to Defend Action Where Policies Limited Coverage to Insured's Duties as Officer, Tenth Circuit Concludes

The U.S. Court of Appeals for the Tenth Circuit, affirming a decision by the U.S. District Court for the Western District of Oklahoma, has ruled that an insurer had no obligation to defend and indemnify an individual sued for misappropriation of trade secrets and breach of contract under insurance policies issued to the company of which he was president.

The Case

Several years after Myron Butler and Carl Bright formed iBall Instruments LLC, Bright went to an Oklahoma state court for a declaration concerning the ownership and control of the company. The parties settled the lawsuit with an agreement (the "Settlement Agreement") that granted Bright 100 percent ownership of iBall and assigned its intellectual property to him.

Thereafter, Bright and iBall sued Butler for misappropriation of trade secrets and breach of contract. The insurer that previously had issued a business owners insurance policy and a commercial liability insurance policy to Telecomm Consultants, Inc. ("TCI") contended that it had no obligation to defend and indemnify Butler, TCI's president, because he was insured under the policies "only with respect to [his] duties" as a corporate officer of TCI.

The U.S. District Court for the Western District of Oklahoma granted summary judgment in favor of the insurer, and Butler and TCI appealed to the 10th Circuit.

The Tenth Circuit's Decision

The Tenth Circuit affirmed.

In its decision, the circuit court explained that TCI's insurance policies provided coverage only for Butler's actions taken in his capacity as a corporate officer of TCI. The circuit court, after reviewing the claims in the action against Butler, then agreed with the district court's conclusion that TCI was not a party to the action, that Bright and iBall did not assert any claims against TCI, and that they did not allege that Butler had been acting at any time on TCI's behalf.

The Tenth Circuit was not persuaded by Butler and TCI's argument that the insurer had to tender a defense because: (1) TCI signed the Settlement Agreement; (2) Butler was an executive officer of TCI; and (3) Bright intended to add TCI as a named defendant. The circuit court reasoned that, in view of the "plain language" in the action that Butler and TCI had filed, which was "uncontradicted by other evidence," the first two factors did not establish a duty to defend or indemnify and the third factor was not substantiated with any evidence.

Finally, the circuit court rejected the argument by Butler and TCI that it was the insurer's burden to show that Butler had not been acting in his executive capacity with TCI, ruling that this argument misstated the allocation of burdens.

The Tenth Circuit concluded that the district court had properly entered judgment in favor of the insurer.

The case is *State Farm Fire and Casualty Co. v. Telecomm Consultants, Inc.*, No. 18-6061 (10th Cir. Dec. 13, 2018).

Corporate Officer and Company Were Not Entitled to Defense in Suit Alleging Breach of Asset Purchase Agreement, Eighth Circuit Rules

The U.S. Court of Appeals for the Eighth Circuit, affirming a district court's decision, has ruled that an insurer had no obligation to defend a corporate executive or his company in a lawsuit stemming from the alleged breach of an asset purchase agreement.

The Case

In February 2012, Eagle Well Services, Inc., sold its assets to a predecessor of Sun Well Services pursuant to an asset purchase agreement. Eagle Well and Robert Mau – the president of Eagle Operating, Inc.; shareholder and president of Eagle Well; director and president of MW Industries, Inc.; and an owner of American Well Services – were parties to the agreement, which included a noncompetition covenant.

After the agreement was signed, MW sold equipment to American Well. Claiming that the sale violated the noncompetition covenant, Sun Well sued Mau for breach of contract, fraud, and civil conspiracy, and it sued Eagle Well for breach of contract and fraud.

The insurer for Eagle Operating and its subsidiary, MW, declined to defend the suit, and Mau and Eagle Well sued the insurer.

The U.S. District Court for the District of North Dakota granted summary judgment in favor of the insurer, and Mau and Eagle Well appealed.

The Eighth Circuit's Decision

The Eighth Circuit affirmed.

In its decision, the circuit court first rejected Mau's argument that the insurer owed him a duty to defend because Sun Well sued him in his capacity as a director and officer of MW, an insured subsidiary of Eagle Operating. The Eighth Circuit reasoned that Sun Well's claims did not depend on any actions Mau took as president of MW, as evidenced by the fact that Sun Well did not sue MW.

The circuit court conceded that Sun Well's complaint mentioned MW contextually, but pointed out that MW was not a party to the suit.

Instead, the circuit court continued, Sun Well's claims depended on the alleged breach of the noncompetition covenant in the agreement between Eagle Well and Sun Well, "an agreement to which MW was not a party." The circuit court added that Sun Well would have no claim for breach of contract, fraud, or civil conspiracy against Mau were it not for the agreement, which he signed as president of Eagle Well, not as a director and officer of MW. Thus, it found, Sun Well sued Mau in his capacity as president of Eagle Well. Because Sun Well's complaint contained no claims based on any actions Mau took as a director and officer of MW, the insurer owed him no duty to defend on that basis.

The Eighth Circuit concluded that the insurer also did not have to defend Eagle Well. It found that a contract exclusion in the insurance policy precluding coverage for claims arising from the insured's contracts or agreements unless liability otherwise would exist in the absence of the contract or agreement applied to Eagle Well because Sun Well's claims against Eagle Well for breach of contract and fraud were based on, arose from, or were related to the agreement, and Eagle Well could not have incurred liability in the absence of the agreement.

The case is *Mau v. Twin City Fire Ins. Co.*, No. 17-3392 (8th Cir. Dec. 6, 2018).

Defects, Errors, and Omissions Exclusion Barred Coverage for Damage to Building's Windows, According to Texas District Court

A federal district court in Texas has ruled that the defects, errors, and omissions exclusion in a builders risk insurance policy precluded coverage for damage to a building's windows, and that an exception to the exclusion did not reinstate coverage.

The Case

In July 2014, a developer contracted with Balfour Beatty Construction, LLC, for the construction of an office building in Houston. The contract required that the developer acquire builders risk insurance covering Balfour Beatty and subcontractors in the project; the developer did so.

In August 2014, Balfour Beatty subcontracted with Milestone Metals, Inc., to weld a two-inch plate onto the building. Milestone completed welding work near the 18th floor of the building in October 2015.

Several months later, Milestone learned that welding slag (that is, molten metal particles ejected in the process of welding) from its operations had fallen down the side of the building and damaged glass on windows. The windows, which Milestone had not installed, had to be replaced.

After learning of the window damage, the developer, Balfour Beatty, and Milestone tendered a claim to the insurer that had issued the builders risk policy. The insurer denied the claim, citing the policy's defects, errors, and omissions exclusion, which excluded claims for "damage . . . caused by, or resulting from an act . . . or omission (negligent or not) relating to . . . construction."

Balfour Beatty and Milestone (the "plaintiffs") sued the insurer for breach of contract. They argued that the exclusion only applied to repairing or replacing an insured's *own* work and that, if an insured's work damaged other parts of the construction site on which the insured was not working, then the exclusion did not apply. They also contended that, even if the exclusion applied, an exception to the exclusion reinstated coverage.

The insurer moved for summary judgment on the plaintiffs' breach of contract claim.

The District Court's Decision

The district court granted the insurer's motion.

In its decision, the district court reasoned that the claim in this case was for damage caused by an act relating to construction – that is, "the process of constructing something." Therefore, the district court decided, it was "excluded."

The district court was not persuaded by the plaintiffs' argument that the purpose of procuring builder's risk insurance was to cover claims such as theirs. The district court said that argument was "unavailing" given that the exclusion did not exclude only claims based on defects or damages to the plaintiffs' own work.

Moreover, the district court ruled, the exclusion was triggered even if wind was a "concurrent cause" that combined with Milestone's welding operations to cause the damage to the building. The district court explained that, in cases involving concurrent causation, Texas law provides that the excluded and covered events combined to cause the injuries and, because the two causes could not be separated, the exclusion was triggered.

The district court then rejected the plaintiffs' contention that the exception to the exclusion reinstated coverage. The district court pointed out that there was only one instance of loss or damage in this case: the damage to the windows. The district court found that the exception suggested that there needed to be at least two loss events for it to apply: (1) an excluded peril that (2) "results in" a covered peril. The "results in" language was not ambiguous and was capable of being given a definite meaning, the district court concluded.

The case is *Balfour Beatty Construction, LLC v. Liberty Mutual Ins. Co.*, No. 4:17-CV-02477 (S.D. Tex. Dec. 28, 2018).

Insurer Had No Duty to Defend Insured for Environmental Claims Where It Was Not In "Defensive Position," Washington District Court Rules

A federal district court in Washington has ruled that an insurer had no obligation to defend a company that had received communications regarding contamination on its property from environmental regulators where those communications did not put the company "legally in a defensive position."

The Case

A company that operated a lumber mill on property in Seattle from 1888 until 1955 applied to the city to subdivide the property, which had contaminated soil. The city approved the application, and subdivided the property into eight parcels.

After the company sought to redevelop one of the parcels and participate in the Voluntary Clean-up Program ("VCP"), the Washington Department of Ecology ("DOE") required, among other things, that the company investigate and characterize the scope of soil contamination at the site, prepare a remedial investigation and feasibility study, and prepare a cleanup action plan.

The company submitted the study and cleanup action plan and the DOE accepted the company's application to enter the VCP on January 20, 2017; the DOE issued an opinion letter dated January 3, 2018.

The company had purchased primary comprehensive general liability insurance and excess liability insurance policies from an insurer between 1969 and 1979. In December 2015, the company notified the insurer of potential claims under the policies for damages, defense, and indemnity related to the soil contamination and cleanup costs at the property. The insurer asked the U.S. District Court for the Western District of Washington to declare that it did not owe the company a duty to defend for the conditions placed on its ability to redevelop its property. The insurer argued that its duty to defend was not triggered until a "suit" was filed against the company and that no such suit had been filed.The insurer moved for summary judgment on its declaratory judgment claim.

The District Court's Decision

The district court granted the insurer's motion.

In its decision, the district court explained that the company was voluntarily developing its property and encountering administrative obstacles to that development. The court added that, if the company decided that the costs of redevelopment were too high, it might be able "to simply scrap its plans without facing any further liability."

According to the district court, the communications from the DOE prior to the insurer's lawsuit did not present "an express or implied threat of immediate and severe consequences" if the company simply maintained the status quo. Put differently, the district court observed that the company was "not legally in a defensive position."

The district court also decided that the January 3, 2018 opinion letter from the DOE also did "not *compel* cleanup action." The district court found that the DOE's role in the VCP stood in "stark contrast to the enforcement methods" it had available to compel cleanup of hazardous materials.

Accordingly, the district court concluded that the insurer's duty to defend had not been triggered.

The case is *Continental Casualty Co. v. C.D. Stimson Co.*, No. C17-235 RSM (W.D. Wash. Dec. 14, 2018).

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