RIVKIN RADLER LLP
ATTORNEYS AT LAW

December 2023 | Insurance Update | WWW.RIVKINRADLER.COM

Hawaii Supreme Court Rules That Insurer May Not Recoup Defense Costs Absent an Express Reimbursement Clause in Policy

On certified question from a federal district court, the Supreme Court of the State of Hawaii ruled that an insurer that defends under a reservation of rights may not seek equitable reimbursement from the insured unless the policy expressly allows. Reserving the right to reimbursement in a letter will not do.

The court gave three reasons for its decision.

First, a reservation of rights letter reinforces defenses and exclusions in the insurance contract. The insurer's reservation cannot create new rights. If the policy does not call for reimbursement, the insurer simply cannot reserve that right.

Second, reimbursement clashes with the duty to defend. In mixed actions – where there are both covered and noncovered claims – the insurer must defend all claims. According to the court, allowing reimbursement of defense costs would erode that broad duty.

Third, the court found that an insured would not be unjustly enriched by receiving a complete defense that included claims not covered by the policy. The court said defense is part of the deal and the insurer benefits by getting to control the litigation.

The Hawaii Supreme Court's decision departs from other jurisdictions, like California, that permit an insurer to recoup defense costs for noncovered claims as long as the insurer adequately informs the insured in its reservation of right letter.

The case is *St. Paul Fire & Marine Ins. Co. v. Bodell Constr. Co.*, No. SCCQ-22-0000658 (Haw. Nov. 14, 2023).

Illinois Supreme Court Finds That Townhome's Water Damage Suit Alleged Property Damage Caused by an Occurrence but Directs Trial Court to Consider Exclusions

Noting that caselaw involving coverage for construction defects claims is in flux, the Supreme Court of Illinois, for the first time, sought to bring clarity to this area of law.

After discovering water damage in several townhomes, a townhome owners' association sued its general contractor for faulty workmanship. The association alleged that subcontractors performed the work, and that the general contractor did not intend to cause the defects or the resulting water damage. The association sought to recover the costs to repair the defects and "other property" damaged because of the defects.

The general contractor was an additional insured under a policy that Acuity issued to a subcontractor. The general contractor tendered the suit to Acuity for defense, but Acuity denied coverage because the complaint did not allege "property damage" caused by an "occurrence." Acuity argued that the association's claimed damages arose out of the townhomes' defective construction and any damage was the natural and ordinary consequences of the defectively performed work. The trial court agreed with Acuity, the intermediate appellate court reversed, and the case made its way up to the Illinois Supreme Court.

The parties agreed that under Illinois law, there could be no "property damage" caused by an "occurrence" unless the complaint alleged property damage to something beyond the townhome construction project. The association's complaint broadly alleged damage to "other

property." The parties framed the dispute as whether this broad allegation was enough to create a potential for coverage.

But the Illinois Supreme Court wasn't sure about the parties' premise. The court said that Illinois law in this area developed from cases applying a myriad of rationales and factors. To arrive at the correct result, it needed to return to the basics.

The court first considered whether the association's complaint asserted claims within the policy's coverage grant.

Did it allege "property damage"? The court said yes. The complaint alleged that faulty exterior work resulted in water and moisture damage to interior townhome units, and this constituted physical injury to tangible property as defined in the policy.

Was the "property damage" caused by an "occurrence"? The court said yes. The policy defined "occurrence" as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions." The court observed that "accident" reasonably encompasses the unintended and unexpected harm caused by negligent conduct.

The association's complaint did not allege that the subcontractor intentionally performed substandard work that led to water damage. Rather, viewing the complaint in the light most favorable to the general contractor, the court found that the association alleged that inadvertent construction defects accidentally caused property damage to the completed townhomes. Neither the cause of the harm (inadvertent defects) nor the harm (resulting water damage to the walls of the interior of the units) was intended, anticipated, or expected.

Acuity argued that damage to any portion of the completed project caused by faulty workmanship can never be caused by an accident because it is always the natural and probable risk of doing business. But the court disagreed. True, a commercial general liability policy does not

insure the cost to repair or replace defective work, but these risks, the court said, are expressed in the exclusion section of the policy, not in the coverage grant.

It held that property damage that results from inadvertent faulty work may be an "occurrence" under the policy's initial grant of coverage in the insuring agreement. And it rejected the parties' premise – that there could be no "property damage" caused by an "occurrence" unless the underlying complaint alleged property damage to something beyond the townhome construction project – because it was not grounded in the language of the insuring agreement.

The court next turned to the exclusions.

It found that the "expected or intended" exclusion did not apply because the complaint expressly asserted that the property damage was neither expected nor intended from the general contractor's standpoint.

The court then considered other exclusions often referred to as the business risk exclusions. The court recognized that coverage ultimately hinges on whether the exclusions and exceptions apply. As neither the parties nor the lower courts addressed these exclusions, the court remanded the dispute to the trial court to make this determination.

In short, the court found that faulty workmanship can be an "occurrence," but whether the claim is covered will be determined by the policy's exclusions, which usually bar coverage for the cost to repair or replace the insured's faulty work.

The case is *Acuity v. M/I Homes of Chi., LLC*, No. 129087 (Ill. Nov. 30, 2023).

Supreme Court of Appeals of West Virginia Holds that Continuous Trigger Applies to Latent Bodily Injury Claims

Sistersville Tank Works (STW) was a family-owned company that supplied the Mid-Ohio Valley region with oil field boilers, tanks, and pressure vessels. From 1985 through 2010, Westfield

Insurance Company issued commercial general liability policies to STW. The policies were standard 1966 CGL occurrence policies.

In 2016, three men sued STW in West Virginia state court. The claimants alleged that STW had carelessly manufactured, installed, inspected, repaired, or maintained tanks at a chemical plant. The claimants worked at the plant and around STW's tanks for various times between 1960 and 2006. They alleged repeated exposure to cancer-causing chemical liquids, vapors, or fumes that escaped from the tanks.

STW tendered the suits to Westfield for defense and indemnity. Westfield denied coverage and filed a declaratory judgment action in federal court. Westfield claimed that it had no duty to defend or indemnify STW because claimants were diagnosed four years or more after the last CGL policy expired. In doing so, Westfield argued for a manifestation trigger. STW argued for a continuous trigger, contending that all 25 Westfield policies were in play.

The district court ruled for STW, finding that Westfield owed coverage under all of its policies. Westfield appealed to the Fourth Circuit, who certified to the Supreme Court of Appeals of West Virginia the question of the appropriate trigger of coverage in a latent bodily injury case.

The court held that a continuous trigger applied to a latent bodily injury case. Tracing the drafting history behind the CGL policy, the court emphasized the shift in 1966 from coverage for "accidents" to coverage for "occurrences." This change, the court noted, showed that what mattered for purposes of trigger was determining the result of the occurrence, not the cause, and that insurers intended to cover gradual injuries.

The court found that the drafters of the 1966 CGL policy rejected a "manifestation" trigger because it was impossible to know precisely when an injury was discovered. Nor did the drafters think it was fair to telescope all damages from a continuous injury into a single year. Rather, the

court concluded, it is more efficient to spread the risk widely to all occurrence-based policies in effect during the entire period of injury or damage. The court added that the policy language supported this result: a policy responds when the damage "occurs," not when discovery occurred. And the court cited authority showing that most jurisdictions apply a continuous trigger.

The case is *Westfield Ins. Co. v. Sistersville Tank Works, Inc.*, No. 22-848 (W. Va. Nov. 8, 2023).

Ninth Circuit Holds That Insurer Had No Duty to Defend Trademark Claim by Rental Car Company

Under a franchise agreement, AutoDistributors could operate a Sixt rental car franchise and use Sixt's trademarks as part of its rental business. Sixt sued AutoDistributors for violating the franchise agreement because AutoDistributors also allegedly used Sixt's trademarks for its used car business.

AutoDistributors tendered the suit to Scottsdale Insurance for defense, but Scottsdale denied coverage based on a trademark exclusion. AutoDistributors then sued Scottsdale for breach of contract in federal court in California. The district court ruled for the insurer and AutoDistributors appealed to the Ninth Circuit.

AutoDistributors sought a defense under its personal and advertising injury coverage. The policy defined "personal and advertising injury" to include certain offenses, including: "infringing upon another's copyright, trade dress or slogan in your 'advertisement'" and "the use of another's advertising idea in your 'advertisement.'"

The policy had an intellectual property exclusion that excluded "'personal and advertising injury' arising out of the infringement of copyright, patent, trademark, trade secret or other

intellectual property rights." The exclusion, however, did not apply to "infringement, in your 'advertisement,' of copyright, trade dress or slogan."

Sixt accused AutoDistributors of trademark infringement. This claim fell squarely within the intellectual property exclusion, so why did AutoDistributors think it was entitled to coverage?

AutoDistributors argued that it was entitled to a defense because Sixt alleged other "personal and advertising" injuries beyond just trademark infringement.

AutoDistributors argued that Sixt's complaint could be read as alleging slogan infringement. But the Ninth Circuit disagreed, finding the word "slogan" appeared only once in the complaint. The complaint described AutoDistributors' use of Sixt's trademarks, not its slogans.

AutoDistributors argued that the complaint included a claim for using Sixt's advertising ideas. To support this contention, AutoDistributors submitted a declaration from its principal stating that AutoDistributors adopted Sixt's advertising and marketing materials by creating "an electric scooter to rent and sell to [AutoDistributors'] customers, which utilized Sixt's distinctive orange and black color scheme and one of its slogans—'Feel the Motion.'"

Again, the Ninth Circuit was not buying it, because those facts are nowhere in Sixt's complaint, and AutoDistributors did not explain why these facts would have been "otherwise known" to Scottsdale. The court emphasized an important principle when assessing the duty to defend. The extrinsic facts must be known by the insurer at the beginning of the underlying suit. An insured may not trigger the duty to defend by speculating about extraneous facts on potential liability or ways for the claimant to amend its complaint in the future.

Under a fair reading of the complaint, the Ninth Circuit concluded that all claims fell outside of coverage. Scottsdale had no duty to defend.

The case is *AutoDistributors, Inc. v. Nationwide E&S Specialty*, No. 22-16445 (9th Cir. Nov. 17, 2023).

Eleventh Circuit Rules That Claim Was Made Under Professional Liability Policy When Agent Was Served

Professional liability policies are usually written on a claims-made basis, with coverage retroactive to a specified date. A law firm had a policy that applied to claims made from December 21, 2018, through December 21, 2019. The policy's definition of "claim" included a "civil proceeding commenced by the service of a complaint or similar pleading."

A complaint was filed against the law firm in November 2018. Its registered agent was served with the summons and complaint on December 19, 2018, two days before the policy began. The law firm itself did not receive the papers until December 27, 2018.

The law firm tendered the suit to its professional liability insurer, Hanover, who denied the claim because it was made two days before the policy started.

The law firm sued Hanover, and in the coverage action, argued that the policy is triggered when the insured learns of the claim. As the law firm first learned of the claim when it received the summons and complaint, which was during the policy period, it contended that it was entitled to coverage.

The Eleventh Circuit disagreed. The policy expressly says when a claim is made – when service of process of a civil proceeding is made, not when the insured learns about the suit. As the law firm's registered agent was served with process two days before the start of the policy period, the claim was first made outside the policy's coverage. Hanover was awarded judgment on the pleadings.

The case is *DC Cap. Law Firm, LLP v. Hanover Ins. Co.*, No. 23-10169 (11th Cir. Nov. 20, 2023).

California's Willful Acts Statute Bars Coverage for Defamation Claim

Wonderful Citrus was accused of falsely telling members of the local farming community that an employee stole from the company. The employee sued for defamation and won. The jury found that Wonderful Citrus had acted with malice and awarded nearly $5 million in damages for reputational harm.

Wonderful Citrus sought reimbursement from its excess insurer, Starr Indemnity, who denied coverage. Wonderful Citrus sued Starr in federal court in California. The issue was whether California Insurance Code § 533 barred recovery. That statute provides:

> An insurer is not liable for a loss caused by the wilful act of the insured; but he is not exonerated by the negligence of the insured, or the insured's agents or others.

An act is willful under § 533 if it is: (1) deliberately done for express purpose of causing damage; (2) an intentional, wrongful act that is inherently and necessarily harmful whether or not the actor subjectively intended harm; or (3) intentionally performed with knowledge that damage is highly probably or substantially certain to result.

The federal district court looked only to the second test and found Wonderful Citrus's defamation per se conviction to be an inherently and necessarily harmful act. The court rejected Wonderful Citrus's argument that defamation does not require a showing of intentional conduct or that it is inherently harmful. The court said that defamation is the intentional written or oral publication of a false and unprivileged statement of fact that has a natural tendency to injure, or which causes special damage.

The jury found that Wonderful Citrus committed defamation per se by accusing the employee of engaging in criminal activity. Under California law, this meant that Wonderful Citrus committed an intentional act which had a natural tendency to injure or cause damage, thus rendering its actions inherently harmful. California caselaw, the court added, "clearly establishes that an act of defamation is inherently and presumptively damaging." This was reinforced by the jury's finding that Wonderful Citrus acted with malice.

The court determined that the jury's finding of defamation per se and malice necessarily includes a finding of inherently harmful conduct, and thus a willful act. Section 533 barred any insurance recovery.

The case is *Wonderful Co. LLC v. Starr Indem. & Liab. Co.*, No. 2:22-cv-08249-FLA (MAAx) (Oct. 31, 2023).

Montana Federal Court Finds One Occurrence for Carbon Monoxide Exposure Claim

The insured, Rainbow Ranch, operated a hotel where the underlying claimants, a married couple, stayed in January 2021. The married couple experienced carbon monoxide exposure in their room. The husband died. The widow sued Rainbow Ranch and its manager in Montana state court. Western National tendered the policy limits of $6,020,000. This amount represented the sum of the $1 million per occurrence limit under the CGL policy, the $5 million limit under an umbrella policy, and $20,000 in medical payments coverage. But the insured sought two limits.

Western National filed an action in federal court for a declaration that there was only one occurrence and moved for judgment on the pleadings.

The court granted Western National's motion, finding that Montana looks to the cause of the alleged injuries in determining the number of occurrences. The policy defined "occurrence" as

a “continuous or repeated exposure to substantially the same general harmful conditions.” Although multiple negligent acts led to the build-up of carbon monoxide, the court determined that the claimants’ injuries stemmed from one cause, carbon monoxide poisoning. Thus, there was only one “occurrence.”

The case is *Western Nat’l Mut. Ins. Co. v. Rainbow Ranch Holdings, LLC*, CV-23-05- (D. Mont. Nov. 20, 2023).