RIVKIN RADLER LLP
ATTORNEYS AT LAW

January 2024 | Insurance Update | WWW.RIVKINRADLER.COM

South Dakota Supreme Court Finds Auto Policy's Pollution Exclusion Bars Coverage for Tainted Wheat Delivery

The policyholders, who operated a wheat farm, delivered two loads of wheat contaminated with fertilizer to a customer. Upon delivery, the contaminated wheat was dumped into a bin containing 400,000 bushels of wheat. The customer sued the policyholders for its losses.

The policyholders requested a defense from their automobile insurer. The insurer asserted the pollution exclusion and declined coverage. The policyholders sued and the case went up to the South Dakota Supreme Court.

The policy barred coverage for property damage caused by pollutants transported by, carried in or upon, released, discharged, or removed from, or that escape or leak from any motor vehicle. The policy also excluded coverage for suits that are the real or alleged result of the effects of pollutants or in any way associated with the cost of, among others, the "neutralization of the effects of pollutants." The policy defined "pollutants" as "any solid, liquid or gaseous irritant or contaminant, toxic substance, hazardous substance, or oil in any form."

The policyholders argued that the pollution exclusion did not apply because it was meant to limit an insurer's liability for environmental damage, not a tainted wheat delivery to a customer. But the court found that the policy never used the term "environmental" and to limit the policy in the way the policyholders urged would require the court to rewrite the policy. The court found

that the policy's definition of "pollutants" included contaminants and that all the customer's claims arose from the alleged delivery of contaminated wheat.

The policyholders next argued that the exclusion was ambiguous because it used terms of art associated with environmental pollution and thus could lead one to reasonably think that the policy excluded claims for environmental pollution. Applying a literal interpretation of "contaminant," the policyholders argued, would stretch the limited meaning of the pollution exclusion to things that have nothing to do with environmental pollution. But the court disagreed, and relying on its own precedent, found the exclusion to be unambiguous. The court said that the exclusion was not overly broad because for a substance to be excluded, it must meet a precisely drawn circumstance – it must be an irritant or contaminant.

The court found that the exclusion applied and held that the insurer had no duty to defend or indemnify the policyholders in the customer's suit.

The case is *State Farm Mut. Auto. Ins. Co. v. Grunewaldt*, No. 30216 (S.D. Nov. 29, 2023).

Illinois Appellate Court Holds That Insurer Must Defend Village That Purposely Demolished a Residential Building

In July 2016, Willow Way bought a residential building in the Village of Lyons, Illinois. The building needed some repairs and Willow Way hired contractors to perform the work. Most of the work had been completed within a year.

In August 2017, the Village required Willow Way to get new permits and to perform additional work. The Village then put a hold on the project because the repairs had allegedly been done improperly. The Village imposed new requirements, which Willow Way contended were illegitimate.

In January 2018, the Village told Willow Way that it wanted to tear down the structure and imposed new requirements for the renovation. After the work was substantially completed, the Village required more repairs and threatened to immediately tear down the building. Willow Way requested a full list of all required repairs. The Village said the building was beyond repair and in December 2019 placed a notice of intent to demolish on the residence. The Village demolished the building two months later.

Willow Way sued the Village contending that its conduct was not for a legitimate governmental purpose but was to enrich Village officials or their favored partisans. Willow Way also alleged that the Village took its property without just compensation.

The Village sought a defense from Liberty Mutual. Liberty insured the Village under three types of policies: commercial general liability, Public Official Liability (POL) policy, and a commercial liability umbrella policy.

Liberty filed a declaratory judgment action in Illinois state court seeking to get clear of any duty to defend or indemnify under all three policies. Liberty prevailed and the Village appealed.

On appeal, the appellate court considered the terms of all three policies but ultimately focused on the POL policy, which covered the Village for wrongful acts. Liberty argued that the POL did not apply because it excluded coverage for "[c]laims arising out of . . . property damage." The Village argued that not all the claims arose out of the demolition of the building, but included allegations about abrogating building permits, unjustified fines, interference with work, and constitutional injuries from Village officials exceeding their authority.

The court said that, viewing Willow Way's complaint as a whole, the allegations went beyond the destruction of the property or Willow Way's tangible property rights. Willow Way alleged that Lyons wrongfully interfered with its rights for years before the demolition. Willow

Way sought to recover for injuries resulting from the Village's machinations related to the property, whether in an effort to obtain the property for itself or simply to deprive Willow Way of it. So, the court found that Willow Way was really alleging damages from the Village's interference with Willow Way's bundle of rights in the property and potential violations of its constitutional rights.

Liberty next argued that Willow Way alleged only intentional acts and that the policy does not cover intentional conduct. The court acknowledged that the policy covers *negligent* acts, errors, or omissions. But the court rejected this argument, finding that the policy was ambiguous because Liberty had to defend some intentional acts until there was a final adjudication of the insured's liability.

The policy had other exclusions for personal profit and taking for public use, but the court held these also did not apply despite allegations that Village officials were motivated to enrich themselves or their constituents. The court said none of these exclusions is clear and free from doubt.

Because the suit raised claims that were within or potentially within the policy's coverage, Liberty had to defend the entire suit.

This seems like an overly broad reading of the allegations. Village officials allegedly did everything they could to stop Willow Way from completing the project and ultimately demolished the building. How is that a negligent act, error, or omission?

The case is *LM Ins. Corp. v. Vill. of Lyons*, 2023 IL App (1st) 221529-U (Ill. Dec. 26, 2023).

South Carolina Court of Appeals Finds Insurer Owed a Defense Even Though the Policyholder Never Asked for One

Typically, a policyholder can forfeit insurance coverage if it doesn't report a lawsuit to its insurer. But in a recent case, the Court of Appeals of South Carolina saw it differently. It upheld an award of bad faith against an insurer who learned of a suit from another but never defended because the named insured never asked for a defense.

The case is long and complicated. We'll try to briefly summarize the facts.

The insurance dispute arose out of a construction defect claim by a homeowners association (HOA) against a developer (and general contractor) and its subcontractors. Penn National Mutual Casualty Insurance Company insured one of the subcontractors, Jose Castillo, who did business as JJA Framing. The HOA's claim involved water intrusion damage discovered several years after the project was completed.

Before the project, JJA Framing agreed to defend and indemnify the developer for claims arising out of its work and named the developer as an additional insured under its policies with Penn National.

The developer believed that JJA Framing's work contributed to the damage and requested that Penn National defend it as an additional insured. The HOA also sent the complaint to Penn National and warned that it would be moving for a default judgment against JJA Framing.

Penn National declined to defend the developer on the grounds that the developer did not qualify as an additional insured for matters involving completed operations. The developer filed a declaratory judgment action against Penn National while the underlying action was ongoing. The HOA was also named in that suit and cross-claimed against Penn National as assignee of the developer's "bad faith rights."

The HOA eventually settled its claims against the developer and obtained a default judgment against JJA Framing. JJA Framing assigned its insurance rights to the HOA.

In the declaratory judgment against Penn National, the developer and the HOA sought to recover the developer's defense costs and settlement payment, the amount of the default judgment against JJA Framing, bad-faith damages, punitive damages, prejudgment interest, and attorneys' fees.

The bench trial did not go well for Penn National, and it was found liable for more than $27 million. Penn National issued eight successive policies to JJA Framing, each with $500,000 liability limits. So, its liability was far beyond the total policy limits.

The court found that Penn National knew shortly after receiving notice from the developer that the HOA complaint triggered coverage and that JJA Framing's exposure was likely in the millions of dollars. But Penn National decided that it would not defend JJA Framing until JJA Framing specifically requested a defense. The court found that the notice and cooperation conditions of the policy did not require the insured to specifically request a defense and observed that Penn National defended Castillo in other cases where he did not expressly request a defense.

Penn National never received notice from JJA Framing. But Penn National sent three reservation of rights letters to JJA Framing. The Penn National claims representative had trouble locating the insured because it had reincorporated and changed its address. But the claims representative hired an investigator to track down Castillo. The investigator found Castillo and asked if he wanted Penn National to defend JJA Framing in the HOA suit. Castillo said no and declined to provide any further contact information. Castillo would later testify that he was not told that Penn National would absorb the cost of the defense and that he would have answered

differently had he known. The court found that Penn National did not disclose all the facts to allow Castillo to make a fully informed decision.

JJA Framing and Castillo did not comply with the notice condition of the Penn National policy. But the court found that Penn National had actual notice of the suit even before JJA Framing was served. It held that Penn National was not prejudiced by the lack of notice from JJA Framing because it was not prevented from investigating the claim.

Penn National raised many issues on appeal. We can't cover them all here and will focus just on Penn National's waiver issue. Penn National argued that JJA Framing's failure to give notice, its declination of a defense, and its failure to cooperate, violated the policies' conditions and terminated any defense obligation that Penn National may had. Penn National also argued that Castillo's declination of Penn National's offer of a defense constituted a knowing and voluntary relinquishment of rights under the policies.

But the South Carolina Court of Appeals disagreed and found that Castillo did not decline coverage. It reasoned that Castillo only had limited information when he interacted with the investigator during a "cold call" in his garage. It agreed with the trial court that Penn National was not prejudiced by the lack of notice from JJA Framing because Penn National knew of the suit and was able to respond.

The court also found that Penn National was not prejudiced by the lack of cooperation. Penn National argued that it was ethically unable to appoint counsel without Castillo's express permission. The court said it was not bound by the federal decisions applying that rule and distinguished those decisions because Penn National never tried to hire an attorney for JJA Framing or Castillo.

The appellate court affirmed the trial court on all other issues.

The lesson here is that insurers must tread cautiously when asserting a waiver defense. If the insurer truly believes that its policyholder is waiving its rights to a defense of a covered claim, at the very least, the insurer must disclose all facts to the insured, inform the insured of the consequences of its decision, and document that in a writing signed by the insured. Penn National did not do that here and became responsible for damages well beyond the policy limits.

The case is *Portrait Homes-S.C., LLC v. Penn. Nat'l Mut. Cas. Ins. Co.*, No. 6038 (S.C. Ct. App. Dec. 13, 2023).

Third Circuit Rules That Professional Services Exclusion Bars Coverage under CGL Policy

Borden-Pearlman Insurance Agency (B-P) hired an employee of a competitor, Orchestrate. The employee allegedly used Orchestrate's confidential information to solicit clients for B-P and badmouthed Orchestrate when speaking to those clients. Orchestrate sued B-P for defamation.

B-P had a commercial general liability policy with Travelers and an errors and omissions policy with Republic. The E&O policy insured B-P for its professional services. The CGL policy, which covered suits seeking damages because of personal injury, excluded Financial Professional Services.

B-P asked Republic and Travelers to provide a defense and indemnification, but both declined.

B-P later sued Republic and obtained a judgment declaring that Republic had a duty to defend it in the lawsuit. Republic allegedly spent millions of dollars defending B-P. To recoup some of those costs, Republic sued Travelers for contribution. The federal district court ruled for Travelers and Republic appealed.

The Third Circuit affirmed. Applying New Jersey law, the court ruled that the Financial

Professional Services Exclusion in the CGL policy applied and thus Traveler's did not have a duty to defend.

Whether a professional services exclusion applies, the court noted, turns on whether the liability "flowed directly" from a professional activity. The underlying complaint alleged that B-P used confidential information obtained from the employee to inform Orchestrate's current and prospective clients. These statements went beyond general commercial solicitation because they discussed considerations unique to the insurance needs of specific clients and were the kind of "advising" or "recommend[ing]" contemplated by the Financial Professional Services Exclusion. And these communications were also alleged to have been made when B-P had preexisting professional relationships with the recipients of the communications. The court thus denied Republic's claim.

The case is *Republic Franklin Ins. Co. v. Travelers Cas. Ins. Co. of Am*., No. 22-2432 (3d Cir. 2013).

Ninth Circuit Enforces Suit Limitation Clause for Latent Property Damage Claim

A condominium association claimed to have discovered in 2018 structural damage caused by rain events dating to 1990. It sought recovery from its insurers, who denied the claim. The condominium association sued its insurers in federal court in the state of Washington.

State Farm insured the condominium association from 1989 to 1990. Its policy had a suit limitation clause that stated: "No action shall be brought unless … the action is started within one year after the occurrence causing loss or damage." The district court enforced this clause and awarded summary judgment to State Farm. The condominium association argued that the suit limitation applies only after discovery of the damage and appealed.

On appeal, the Ninth Circuit found that the policy unambiguously required the condominium association to bring suit within one year of rain events. Because the condominium association did not sue until nearly 30 years later, the policy barred the claim.

The condominium association pointed to Washington Supreme Court authority that permitted a suit to be brought within one year after the "hidden" loss was discovered. But the Ninth Circuit rejected the condominium association's argument because the policy language in that case differed. It stated that suit must be brought within one year "after a loss occurs." In contrast, the State Farm policy stated that suit must be brought within one year "after the occurrence causing loss or damage."

The Ninth Circuit said this distinction makes a difference. The phrase "after a loss occurs" focuses on the triggering event of the loss. The phrase "after the occurrence causing loss or damage" focuses on the triggering event of the cause. The "loss" may not have "occurred" until the hidden decay was exposed to view, but the "occurrence" causing the loss are rainstorms that took place during the policy period. The condominium association did not argue that the rainstorms were concealed from view.

The Ninth Circuit also explained that even if it were to interpret "occurrence" to include continuous occurrences, any occurrence that took place after the policy period cannot cause loss during the policy period, as is required to trigger coverage.

The Ninth Circuit found that the condominium association had to sue State Farm by 1991. It thus affirmed the district court's ruling.

The case is *Gold Creek Condominium-Phase I Ass'n of Apt. Owners v. State Farm Fire & Cas. Co.*, No. 22-35606 (9th Cir. Dec. 18, 2023).

Kentucky Federal Court Finds No Occurrence for Faulty Workmanship Claim

HRB owned a Louisville apartment complex. It sued its general contractor, Doster Commercial Construction, for allegedly faulty concrete work in certain apartments. Doster added its concrete subcontractor, Kentuckiana Commercial Concrete, LLC, as a potentially liable party.

Kentuckiana sought coverage under its commercial general liability policy with Westfield Insurance Co. The Westfield policy afforded Kentuckiana a defense and indemnification for claims of "property damage" caused by an "occurrence." Occurrence meant "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

Westfield agreed to defend Kentuckiana under a reservation of rights but refused to defend Doster as an "additional insured" under Kentuckiana's policy. Westfield then sued both Kentuckiana and Doster in federal court, seeking a declaration that it had no duty to defend either. The parties cross-moved for judgment on the pleadings.

The court applied Kentucky law and ruled for Westfield. Under Kentucky law, an accident occurs if the insured did not intend the event or result to occur, and the event or result that occurred was a chance event it could not control.

The gist of the claims against Doster, which Doster sought to shift to Kentuckiana, was that the contractors failed to ensure quality workmanship and compliance with the terms of the construction contract. These allegations did not constitute an occurrence. The court noted that Kentucky courts have consistently held that faulty workmanship claims don't constitute accidents or occurrences because such claims do not implicate events beyond the insured's control. To hold otherwise, the court observed, would essentially convert Kentuckiana's CGL coverage into a construction bond.

The court rejected Kentuckiana and Doster's reliance on canons interpreting exclusions generously in favor of the insured. Here, the question concerned the coverage grant, not the exclusions. Thus, such interpretative canons were inapplicable.

The court granted Westfield's motion and held that it had no duty to defend or indemnify Kentuckiana or Doster in the underlying action.

The case is *Westfield Ins. Co. v. Kentuckiana Commer. Concrete, LLC*, No. 3:20-cv-639-BJB (W.D. Ky. Dec. 12, 2023).