COVERAGE OPINIONS
Judicial Opinions Today - Impact On Counsel's Opinions Tomorrow

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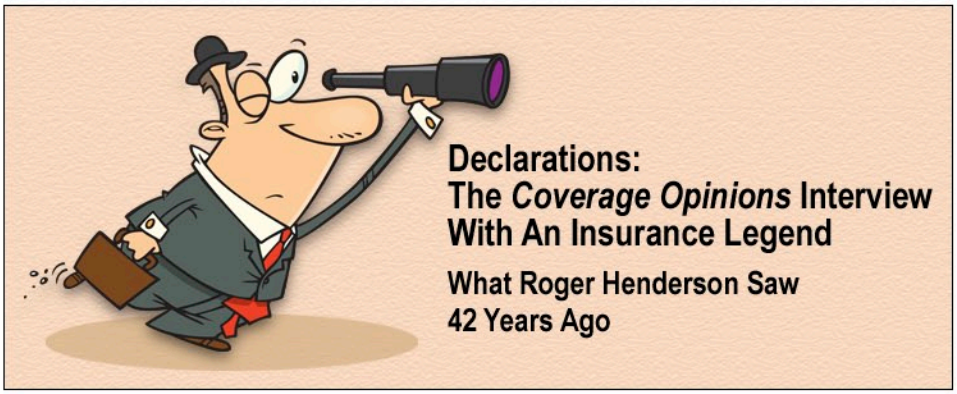
The Cover-age Story



In 1971 Roger Henderson was a sixth year lawyer. He had a couple of years of personal injury defense under his belt, served as a Teaching Fellow at Harvard Law School for a couple more and was now an Associate Professor at The University of Nebraska College of Law. Yet, somehow, despite such limited experience, Professor Henderson managed to publish a law review article that I believe is the most influential ever written in the area of insurance coverage. I know some sixth year lawyers that I wouldn't want representing me on a ticket over an expired parking meter.

A lot of law review articles get published. Presumably, those writing these scholarly works hope for them to have an influence in shaping the law. I suspect that most don't. But Professor (and later Dean) Henderson's article did – in the area of insurance coverage. And not just concerning one issue, but two. And we're not talking about obscure issues here. Rather, two of the most important – construction defects and asbestos. But, remember, the article was published in 1971, a long long time before these issues had developed, yet alone exploded, into two of the most frequently and fiercely litigated, and expensive, that the insurance industry has ever seen.

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In this issue:

Coverage Opinions: Celebrity Endorsement:

Believe me, I was shocked too when former World Heavyweight Boxing Champion, and Olympic Gold Medalist, Leon Spinks, told me that the only thing more exciting than beating Muhammad Ali is getting his bi-weekly issue of *Coverage Opinions.* See page 8 for a picture of the Champ with his favorite insurance coverage newsletter and sparring with me about gap insurance.

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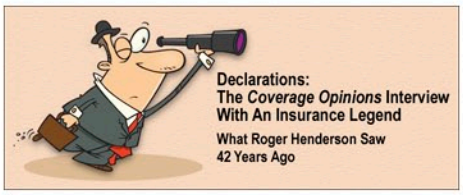

It is remarkable how prescient Dean Henderson was in tackling these coverage issues when he did. I asked him last week who he liked in the Preakness and without a moment's hesitation he said Oxbow.

The article about which I'm referring is "Insurance Protection for Products Liability and Completed Operations – What Every Lawyer Should Know," published in the Nebraska Law Review (50 Neb. L. Rev. 415 (1971)). By my count, the article has been cited by 140 courts and 38 law reviews or journals.

In the area of construction defect, "What Every Lawyer Should Know" is frequently cited for the proposition that a commercial general liability policy is intended to provide "coverage . . . for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained." In other words, Dean Henderson's article is often part of the discussion that leads to the conclusion that a CGL policy does not provide coverage for the repair or replacement of an insured's own defective workmanship, but provides coverage for bodily injury or property damage to others caused by an insured's defective workmanship. And this is far and away the most often stated principle concerning the scope of coverage for construction defects (as well as coverage for an insured's products and operations in general).

Some courts have relied on this principle to conclude that faulty workmanship, to an insured's own work, is not an "occurrence." This issue is at the heart of the battle that has been raging over the extent of coverage for construction defects. "What Every Lawyer Should Know" has played an important part in several seminal decisions addressing this issue. And those decisions have gone on to play a part in other courts' decisions on the subject.

While virtually all courts agree with Dean Henderson's conclusion, that no coverage is owed for the repair or replacement of an insured's own defective workmanship, but coverage is provided for bodily injury or property damage to others, caused by an insured's defective workmanship, not all do so by concluding that faulty workmanship is not an "occurrence." Some reach Dean Henderson's conclusion on the basis that faulty workmanship is an "occurrence" and the absence of coverage for an insured's own defective workmanship must come from exclusions.

For a discussion of this issue, see the superb article published just last week by Carl Salisbury, of Kilpatrick Townsend Stockton LLP, on Law360. Mr. Salisbury takes issue with courts that have held that faulty workmanship,

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About The Editor

Randy Maniloff

Randy J. Maniloff is an attorney in the Philadelphia office of White and Williams, LLP. He concentrates his practice in the representation of insurers in coverage disputes over primary and excess obligations under a host of policies. Randy is the co-author of "General Liability Insurance Coverage: Key Issues In Every State" (Oxford University Press, 2nd Edition, 2012). For the past twelve years Randy has published a year-end article that addresses the ten most significant insurance coverage decisions of the year completed. Randy has been quoted on insurance coverage topics by such media as The Wall Street Journal, The New York Times, USA Today, Dow Jones Newswires and Associated Press. For more biographical information visit www.whiteandwilliams.com. Contact Randy at Maniloff@coverageopinions.info or (215) 864-6311.

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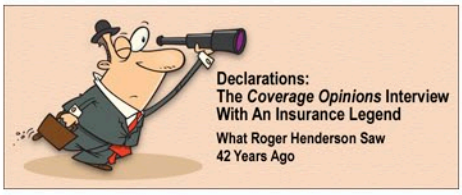

to an insured's own work, is not an "occurrence." Coincidentally, he does so by criticizing the New Jersey Supreme Court's 1979 decision in Weedo v. Stone-E-Brick, Inc. And what did the Weedo court rely on, in no small part, in reaching its decision -- "What Every Lawyer Should Know."

In the area of asbestos coverage, a very significant issue has been how to categorize claims – being products, operations or completed operations. This is an issue with mega-sums possibly riding on the outcome, as it could determine if policies are subject to aggregate caps or un-aggregated occurrence limits. Long before asbestos was a source of coverage disputes, "What Every Lawyer Should Know" addressed, in significant detail, this type of categorization of CGL claims. The article has been cited as part of the discussion of the categorization issue in the context of asbestos claims.

In 1977, after serving as a Professor at Nebraska College of Law, Professor Henderson became Dean of the University of Arizona College of Law, a position he held until 1983. Dean Henderson then continued to teach at Arizona Law for the remainder of his career. He is now the Ralph W. Bilby Professor Emeritus of Law at Arizona. In addition to "What Every Lawyer Should Know," Dean Henderson has published numerous scholarly articles, as well as co-authoring the case book *Insurance Law: Cases and Materials.*

Dean Henderson, thank you for letting me interrupt your retirement to make you try to recall things from 1971. Where did the idea for "What Every Lawyer Should Know" come from?

Well, it certainly was not, as they say, a "Eureka Moment!" Rather, looking back, it resulted from a confluence of forces and opportunities, waxing and waning, over time. First exposed to insurance law when I took a basic course in the subject at the University of Texas Law School, I was then offered a research position, funded by the Defense Research Institute (DRI), where I reviewed and summarized newly decided judicial opinions involving tort and insurance law for possible selection by Dean W. Page Keeton for inclusion under his byline in the "current noteworthy cases" section of the Defense Counsel Journal.

After graduating, I practiced law primarily in the area of personal injury defense which, although not involving very many policy questions, at least permitted some insight into insurance industry practices. I also joined the DRI as the firm thought it might be good for business. I doubt we got much, if any, business from my membership, but it did afford me a steady stream of publications and other material regarding insurance law.

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Randy Spencer's Open Mic

What The Supermarket Tells Us About Insurance Coverage

I was in the supermarket a little while back and just as I put my Rice Krispies on the check-out belt the woman in front of me lunged – now I don't mean reached for, I mean lunged – for that narrow plastic bar to separate her food from mine. You would have thought that Crackle had tuberculosis the way she moved. While I was initially miffed at this woman's suggestion, that my food wasn't good enough to mingle with hers, I actually owe her thanks for the great idea that she gave me.

I took one of those plastic bars from the supermarket and now carry it with me. And anytime someone gets too close to me, like in my personal space, I simply pull it out and place it down between us. I can't think of a nicer way to say – Please get away from me.

In a way, this is what insurance coverage has become between insurers and policyholders. There is a big supermarket plastic bar between the two sides. While the relationship needs to be adversarial sometimes, in my observation it has deteriorated to a point of general

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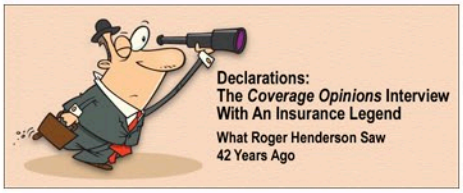

And lo and behold, I subsequently found myself at the Harvard Law School as a Teaching Fellow, which led to more research and other opportunities to work with Professor Robert E. Keeton who, at the time, was working on his insurance law treatise and other insurance related matters such as the Massachusetts no-fault legislation.

From Harvard I joined the University of Nebraska College of Law where I taught torts and insurance law, the two courses I most wanted to teach. Somewhere along the way, I picked up a DRI publication dealing with the 1966 iteration of the Comprehensive General Liability Policy (CGL), the interplay of which with the emerging law of products liability led me to write the article on coverage for product hazards and completed operations.

How is it that a sixth year lawyer, with only a couple of years of private practice experience under his belt, could write such a scholarly and nuanced article on a relatively obscure topic?

I have always felt deeply indebted to Page and Robert Keeton for being my mentors—two outstanding lawyers, scholars, and human beings. They set the standard and had a great influence on me.

In the last paragraph of "What Every Lawyer Should Know" you stated that you hoped that the article would facilitate the resolution of future disputes. Could you ever have imagined how much it would?

No—I probably was just hoping the article would help in getting me promoted to full professor with tenure.

Over the many years did you views change on any of the issues in the article?

Not really, but I must confess that about the time the article was published I became a Reporter for the Uniform Motor Vehicle Accident Reparations Act (the no-fault act) ultimately promulgated by the Uniform Laws Conference (ULC) and that, along with other subsequent tort reform activities (such as periodic payment of tort awards, bad faith actions against insurers, punitive damages, and apportionment of tort responsibility) diverted me from the CGL scene, something to which I was never able to fully return. On the other hand, these projects brought me into regular contact with many individuals and organizations associated with the field of insurance.

"What Every Lawyer Should Know" is frequently cited for the proposition that a CGL policy is intended to provide "coverage ... for tort

Randy Spencer's Open Mic

acrimony that exists too much of the time. I see insurers that are too quick to conclude that coverage is not owed and policyholders that are likewise too quick to assert that every disclaimer by an insurer was done in bad faith. It need not be this way. There is room for improvement on both sides.

I got to thinking about this subject after reading an excellent article in the current issue of Indiana Lawyer by Phil Kalamaros of Hunt Suedhoff Kalamaros. In his article, Phil uses very, very strong language to describe the deterioration of civility in the litigation process. But Phil's solution is not simply to say that we need to be more civil. Rather, his solution is much more pointed -- lawyers need to stop lying and cheating. If that happens, civility will take care of itself.

Phil's article has a lot to offer and it is definitely worth checking out. But I still plan to carry my plastic supermarket bar.

That's my time.

I'm Randy Spencer.

Randy.Spencer@Coverageopinions.info

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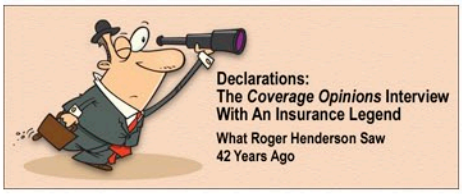

liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or completed work is not that for which the damaged person bargained." Some courts have taken this to mean that faulty workmanship, to an insured's own work, is not an "occurrence." By doing so the court never reaches the exclusions, which means that the insured never has a chance to invoke the "subcontractor exception" to the "your work" exclusion. Question: Is faulty workmanship an "occurrence" and coverage for an insured's own work is excluded by the "your work" exclusion or is faulty workmanship not an "occurrence" and the basis for no coverage ends there?

Removing myself to the time of the article, I did not believe the CGL standard policy was ever intended to cover breach of contract, i.e., *Hadley v. Baxendale* "loss of bargain," damages; and that result obtained regardless of whether the insured was somehow at fault in introducing the deficiency or the deficiency resulted in harm to the product, provided any harm was limited to the product itself. I did not discuss the matter in any detail, probably because it was my understanding that harm to the product itself did not change the general rule in *Hadley*--no tort remedy for breach of contract.

Although I may not have analyzed the issue in terms of whether there was an "occurrence," had I done so I would have said there was no "occurrence." I would say the same today despite the fact that some courts apparently have created exceptions to or otherwise modified the rule announced in Hadley to expand the contract measure of damages. So, simply stated, a deficient product presents a business risk that the CGL policy was never intended to cover unless it causes harm, as defined in the policy, to a third party.

At this point, I will resist the temptation to launch into a dissertation on paying fidelity to underwriting principles and other public policy arguments, not to mention the historical context in which the CGL policy evolved, for not judicially extending coverage as some courts have done. On the other hand, I cannot forego the opportunity to observe that the crux of the problem may well be attributed to a failure of insurers to adequately explain the limited nature of the CGL policy to their insureds. Were they to do so, surely the issue could be resolved through an endorsement or another form of coverage. Insureds desiring broader coverage could obtain it and insurers would be compensated for accepting the risk—surely a more rational way of dealing with the problem than 40 years of legal tug of war in the courts.

In "The Tort of Bad Faith" (1992; University of Michigan Journal of Law Reform) you make clear that there is a need for redress for insurer bad faith, but that insurer claim handling is not as bad as it is sometimes made out to seem. Did you face criticism from those who believe that every foot fault by an insurer is bad faith and needs to be compensated with a huge award?

I do not recall any serious criticism on that point, probably because relatively innocuous, but nevertheless wrongful, conduct usually will not result in large compensatory, much less punitive, awards. Thus, cases involving such are not very attractive from the perspective of the plaintiffs' bar. It is probably the case too that it is easier for the insurer to rectify the situation if it is willing to own up to any misconduct by its representative.

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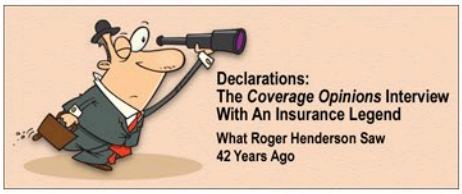

On the other hand, there definitely was resistance to any attempt to tighten the standard of culpability or provide more structure whereby juries consider punitive awards.

Your proposed uniform statutory approach to bad faith never came to pass. Do you believe that that could still happen? [Ironically, and perhaps there is some satisfaction here, for some of the reasons you discussed in your article, the purpose of ALI's Principles of Liability Insurance project is to bring some consistency to an otherwise hodgepodge of coverage rules.]

For the moment, I would say the prospects for tort reform are not encouraging. I am a Uniform Laws Commissioner for Arizona and have been so for over 30 years. In that capacity I once proposed to the ULC Committee on Scope and Program that the Conference undertake to draft a uniform act on insurer bad faith, but the project was not approved. I was not surprised given the number of competing proposals and limited resources. Moreover, the lack of success in obtaining enactments by the ULC regarding prior projects involving tort law, e.g., no-fault auto insurance, comparative fault, periodic payment of awards, and punitive damages, no doubt was taken into consideration by the Committee. In addition, the battles have been so fiercely waged in the past that there appears to be little appetite in the legislatures to take up tort reform. However, the ALI project, as you point out, may have a salutary effect in influencing the courts to bring more harmony to the area.

You taught insurance law and co-authored an insurance case book. So you get it. Why do you believe that so many law schools don't place emphasis on insurance law? Torts gets a lot of glory in the law school curriculum. But it would be a shadow of itself without insurance dollars to pay the settlements and judgments.

Beyond the first year, law school faculties generally do not emphasize particular courses, other than a few of the obvious ones, e.g., constitutional law, evidence, and professional responsibility. In part this is due to a strained sense of comity—"Well, what about my course; it is just as important as yours." Beyond that, insurance law historically at many schools has been taught by adjunct or part-time instructors and they tend to emphasize limited areas such as motor vehicle insurance, something they are probably more familiar with, rather than a more extensive course that covers material that they are less apt to confront in their practices. Sometimes these teachers compile their own materials, which often are more parochial than the case books and other materials designed for the national law school market. Consequently, despite the present cadre of outstanding legal scholars that have chosen insurance law as a primary area of expertise, there still may be fewer insurance law role models in law school *vis-à-vis* other areas.

Of course, this does not answer the question why more full time faculty do not choose insurance law as one of their primary areas of expertise. At one time the teaching materials left much to be desired, but that is certainly not the case today. There are a number of excellent publications from which to choose that present the materials in an engaging and challenging manner. Yet, I have no definitive answer except to say that in nearly 40 years of law teaching and interviewing faculty prospects, I can recall very few candidates who listed insurance law as his or her first or second teaching priority, much less research priority. I can recall none who had any significant exposure to the field, other than practicing in an insurance defense firm or dealing in some manner with health insurance. Perhaps my own experience was unique in being exposed to the field so early in my legal training

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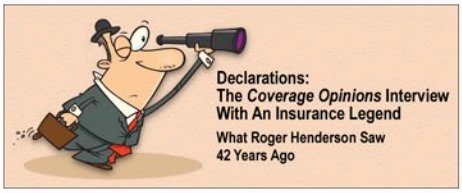

Roger Henderson

and practice and also in having the opportunity to work with those so imminent in the field. For whatever reason, the business of insurance, as well as insurance law, has always fascinated me and I never tired of it. It is just something I have always enjoyed

What have you been doing lately in the insurance arena?

Very little, since I retired and taught my last insurance class in 2008. I'm so busy being retired that I don't know how I ever held a full time job. None the less, I'm still a sucker for some chance to engage over insurance law, as demonstrated by my inability to say "No" to your kind offer to talk to you.
Thanks,
Roger.

Coverage Opinions is a bi-weekly (or more frequently) electronic newsletter reporting and providing commentary on just-issued decisions from courts nationally addressing insurance coverage disputes. Coverage Opinions focuses on decisions that concern numerous issues under commercial general liability and professional liability insurance policies. For more information visit www.coverageopinions.info.

Leon Spinks, Former World Heavyweight Boxing Champ and Olympic Gold Medalist, Shows Off His Favorite Insurance Coverage Newsletter And Spars With Me About Gap Insurance

My Eureka Moment: A Solution To One Of Insurers' Problems With Construction Defect Claims

Like I really need to say this. Liability insurers face significant exposure for things that go wrong on construction projects. This has long been the case with bodily injury. And, of course, more recently, construction defect coverage has been one of the most (if not the most) frequently litigated and hotly contested issues, and sources of significant exposures for insurers, under commercial general liability policies.

I had a eureka moment to solve one of the problems facing insurers with these claims. Bear with me, it takes some background discussion to get there.

One of the reasons why insurers have confronted significant exposure for "property damage," in construction defect claims, is the continuous trigger. In general, courts historically adopted the continuous trigger by concluding that the policy requirement, that "property damage" must occur during the policy period, is more open-ended than insurers had intended. Insurers intended by this requirement that "property damage" must be discovered or become evident during the policy period. Many courts, however, failed to see that qualification in the policy language and adopted the continuous trigger – meaning that all policies on the risk, during a continuous period of property damage, are obligated to provide coverage. Dissatisfaction with the impact of the continuous trigger, on construction defect claims, caused insurers to take a different tack -- adopting policy provisions that are designed to qualify and more specifically pin-point when "property damage" must take place for it to be covered. In essence, insurers have attempted to limit courts' discretion over trigger of coverage and take back control of the issue.

One of the methods that insurers have used, to attempt to do so, are manuscript endorsements, in one form or another, that are generally referred to by such names as First Manifestation Endorsement, Claims in Progress Exclusion, Discovered Injury or Damage Exclusion or Prior Damages Exclusion (collectively "First Manifestation Endorsements"). Such endorsements vary in their language and scope, but are essentially designed to preclude coverage for "property damage" that took place before the policy period, even if the insured did not know that injury or damage had taken place and even if the injury or damage was continuous or progressive. In essence, coverage is limited to "property damage" that first takes place during the policy period. For reasons beyond the scope of discussion here, First Manifestation Endorsements are broader than Montrose Endorsements; and some insurers' endorsements go even further than the First Manifestation variety (see *Coverage Opinions*, November 1, 2012).

One problem for insurers, with applying First Manifestation Endorsements, is that their applicability is tied to certain dates when property damage may have taken place. However, the underlying complaint at issue may not specify such dates. The insurer has no control over the manner in which an underlying construction defect complaint is pleaded – and some plaintiffs likely see an advantage to keeping such "timing" information out of the complaint. Translation – even if an insurer believes that a First Manifestation Endorsement applies, it is still obligated to defend, because it cannot say that it does apply based solely on the information contained in the complaint.

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My Eureka Moment:

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However, while an underlying complaint may not specify the dates needed, to determine that a First Manifestation Endorsement applies, an insurer may still have such information from a source outside the body of the complaint. But the insurer is probably not able to use such information to deny a defense because: (1) the state limits duty to defend determinations to the "four corners" of the complaint; or (2) the state allows extrinsic evidence for purposes of duty to defend determinations, but only for purposes of finding a duty to defend and not for disclaiming one.

This was the precise problem not long ago for the insurer in Greystone Construction, Inc. v. National Fire & Marine Ins. Co., No. 07-66 (D. Colo. Mar. 31, 2013). A construction defect claim was at issue. National Fire sought to disclaim coverage for a defense, based on an endorsement that applied to preclude coverage for property damage that occurs, incepts or first manifests itself before the policy period.

National Fire argued that it had no duty to defend the suit because the alleged damage occurred prior to the start of its policy. Its policy was not effective until 2003, but the loss notice that the insured submitted to it contained expert reports that showed that, by July 2000, the home had experienced some damage.

However, the court rejected this argument because "National Fire relies on facts outside the complaint. The underlying complaint in the Giorgetta lawsuit does not allege when the property damage occurred or was first noticed. Given the absence of an allegation to show that all the alleged damage clearly fell outside of National Fire's coverage period, it is arguable or at least possible that the damage occurred during the policy period. Thus, this provision does not excuse National Fire's duty to defend."

As is often the case in these situations, National Fire had timing evidence – indeed, it came from the insured – that its First Manifestation Endorsement applied. However, it was hamstrung to use it because it was not contained within the body of the complaint. Perhaps the First Manifestation Endorsement will ultimately apply to preclude coverage for any damages. But given how expensive the defense of CD suits can be, even in cases that ultimately settle for small amounts (six figures needed to defend the door bell installer), this may be of little value.

So here is my solution to the problem of insurers being unable to enforce First Manifestation Endorsements, for purposes of the duty to defend, because they are not permitted to look outside the complaint to secure relevant dates. Add language to the First Manifestation Endorsement stating that, for determining if the endorsement applies, for purposes of the duty to defend, the insurer is entitled to rely on certain information (describe what type) even if it is not pleaded in the complaint.

Why not? The cardinal rule of insurance policy interpretation is that the language of the policy controls. In addition, the American Law Institute's "Principles of the Law of Liability Insurance," which is the most talked-about subject in liability coverage today – and written with lots of policyholder participation – specifically includes a principle that supports this proposition.

Chapter 2, Section 15(3)(b) of the Principles states: "For the purposes of determining whether an insurer must defend a claim, the following coverage questions are determined based on all of the facts and circumstances reasonably available to the insurer at the time the determination is made: (b) Whether the events required for the claim to trigger the policy took place within the time period specified by the policy."

Further, the Comment to this ALI Principle makes clear that the "four corners" test does not generally assist in determining whether the events necessary to trigger the policy took place within the time period defined in the policy. The Comment states that such determinations must be based on information not contained within the "four corners" of the complaint. As such, "whether the necessary events took place within the policy period are to be based on all the facts and circumstances reasonably available to the insurer at the time the request to defend is made. Th[is] determination[] [is an] exception[] to the general rule that facts and circumstances not alleged in the complaint cannot be used as a basis for refusing to defend a claim."

Amending First Manifestation Endorsements to specify that, for determining if the endorsement applies, for purposes of duty to defend, the insurer is entitled to rely on certain information, even if it is not pleaded in the complaint, will go a long way toward increasing the frequency in which such Endorsements are upheld in construction defect cases.

Ohio Federal Court: Insurers' Exposure For Construction Projects: A New Frontier?

While much debate has centered around coverage for construction defects, the parties have at least known where the claims are coming from – a structure is set out to be built, something doesn't go right and repairs need to be made. But in IMG Worldwide, Inc. v. Westchester Fire Ins. Co., No. 11-1594 (N.D. Ohio May 13, 2013), an insurer was saddled with exposure for things that did not go right on a construction project, but not because some windows were installed improperly. While the decision arises in a unique posture, limiting its significance, it may nonetheless give rise to similar claims by insureds in like construction situations.

At issue was coverage for claims arising out of a property development deal that went bad. Co-developers sold underlying Plaintiffs undeveloped properties with the promise that they would be upgraded and developed into high end condominiums. The developers were ultimately unwilling or unable to complete the project. IMG Worldwide, while not a co-developer and having no contractual obligation to actually develop the condominiums, allegedly made representations that it was in partnership with the developers and promised to build a sports center in the development once it was built.

The court concluded that IMG could potentially be liable for damages because it allegedly misrepresented its relationship with the developers in advertising and marketing materials in violation of the Florida Deceptive and Unfair Trade Practices Act.

After its insurers denied coverage, IMG settled with the plaintiffs for $5 million, but not before incurring defense costs of $8 million. IMG's primary insurer then settled for the limits of a policy and a payment of $250,000 toward defense costs. Westchester, IMG's excess insurer, continued to deny coverage, a coverage action ensued and it ended up in a jury trial.

The jury concluded that Westchester was responsible for indemnification in the amount of $3,900,000 as IMG had proven by a preponderance of the evidence that coverage was owed as there was an "occurrence" and "property damage." For various reasons, beyond the scope of the discussion here, the court found that Westchester was not liable for defense costs.

On a post-trial motion for a directed verdict/JNOV, the court turned to the "occurrence" issue. The jury found that there was an "occurrence" that triggered the policies. But what was it? The court agreed with Westchester that, if the occurrence were IMG's knowing and intentional misrepresentation, there could be no coverage. But there was evidence presented to the jury of other possible occurrences. IMG maintained that the "occurrence" was the downturn in the economy. However, the court concluded that there was insufficient evidence of this presented at trial.

The court observed that "[i]f the alleged misrepresentation(s), and the downturn in the economy were the only possible events that could constitute an 'occurrence' under the policy, based on the evidence presented at trial, the Court would have no choice but to grant the Defendant's motion[.]" However, the court concluded that there was evidence presented at trial that supported another event that could have served as the 'occurrence' that triggered coverage in the jurors' minds. Specifically, the jury could have found that the abandonment of the project was the cause of the alleged "property damage" by the Plaintiffs. The court noted that there was no evidence presented at trial, nor any indication in the opinions of the court in the Underlying Action, "that the developers' abandonment of the project, even in the absence of any financial investment by IMG, was anything other than an unintended and unexpected event from IMG's perspective."

Turning to the "property damage" requirement, the court determined that there was adequate support for the jury's conclusion. The condominium units, in their undeveloped state, were in a deplorable condition and could not be rented. "The fact that the damages sought could be considered to be 'economic damages' also fails to preclude coverage under the Westchester policies. Because the policies include coverage for loss of use of tangible property, and do not require

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Ohio Federal Court:

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an actual injury to the property at issue, economic damages are contemplated under the coverage language."

IMG Worldwide involves a property development deal gone bad -- presumably, in part, for lack of funding and/or economy-based reasons. These are fundamental and inherent risks of property development. What's more, the underlying claims were for violation of a state's Deceptive and Unfair Trade Practices Act. This is far from the stuff of what's intended to be covered under a general liability policy. The posture of the case – post trial motions that involved getting into the minds of jurors – diminishes the case's significance. Nonetheless, if, from an insured's perspective, a property developer's failure to perform is unintended and unexpected, and, hence, an "occurrence," liability policies may find themselves in the midst of another aspect of the all together risky business that is construction.

Another Acrobatic Interpretation Of An Insurance Policy's Arbitration Clause

It's Time For Insurers To Take Notice

In the last issue of *Coverage Opinions* I reported on the Court of Appeal of California's late April decision in Diamond Blue Enterprises, LLC v. Gemini Ins. Co. At that time I didn't think that the case was overly significant. My main motivation for including it in CO was its unusual conclusion – a clause in an insurance policy, stating that disputes "whether coverage is provided," are subject to arbitration, did not apply to a dispute over defense costs, since the duty to defend is not coverage.

I thought Diamond Blue was worthy of note, for its unusualness, but would have probably never given the case much more thought, if not for the New York federal court's decision two weeks later in United Parcel Service v. Lexington Ins. Co., No. 12-7961 (S.D.N.Y. May 7, 2013). Just like Diamond Blue, the United Parcel Service court used acrobatics to avoid sending a coverage dispute to arbitration. But UPS went a step further. This time it was Cirque du Soleil. Two decisions, two weeks apart, that bent (way) over backwards to avoid arbitration of a coverage dispute, may not be cause for alarm. Nonetheless, insurers that are using arbitration provisions in their policies, and want to avoid the disappointment of having them be declared unenforceable, would be well-served to take note of the lessons that Diamond Blue and UPS provide.

The underlying case at issue is straightforward. UPS hired Adelis to provide UPS with uniformed guards at various locations. Adelis was required to obtain commercial general liability insurance and name UPS as an additional insured. Marilyn Chase, an Adelis employee, was hit by a tug car owned and operated by UPS and its employees. She sued UPS. UPS maintained that the incident was caused in whole, or in part, by Chase's negligence. UPS's insurer sought defense and indemnity from Adelis's insurer, Lexington, as an additional insurerd. Lexington denied the tender on the basis that the incident was the direct result of the negligence of the UPS employee that was operating the tug car. So far this is Freshman Coverage. Here's where it gets more interesting.

UPS sued Lexington. Lexington sought to enforce an arbitration clause in its policy that provided, in relevant part, "[I]n the event of a disagreement as to the interpretation of this policy, it is mutually agreed that such dispute shall be submitted to binding arbitration...." (emphasis added). That sure sounds simple enough.

Not only are the terms of the arbitration clause simple, but so too was Lexington's argument, which is all it should have needed to be: Lexington "'denied coverage under the Additional Insured Endorsement because there was no allegation that Chase's bodily injury was caused by Adelis' negligence,' which was a condition of coverage. Thus, because there is a 'dispute as to what the terms of the Additional Insured Endorsement require for coverage to be triggered, the Policy's Arbitration Clause is implicated.'"

UPS saw it differently: "[T]he action does not hinge on an interpretation of the Additional Insured Endorsement, but rather on the application of the facts to the terms of the Additional Insured Endorsement." (emphasis added). Huh?

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Another Acrobatic Interpretation: - *Continued*

The court adopted UPS's argument and concluded that the arbitration clause did not apply to the parties' dispute over the availability of additional insured coverage. The court agreed with UPS, that its entitlement to coverage under the policy did not require an "interpretation" of the policy, but, rather, an application of the facts to the undisputed terms of the Additional Insured Endorsement. "[T]there is no dispute that coverage is required if Chase's injury was a result, in whole or in part, of Adelis' negligence, and that coverage is not required if the injury was entirely the result of UPS's negligence. The only question then, is whether the facts show that UPS was solely responsible, or whether they show that Adelis' negligence played some role. This is not, as Lexington argues, a dispute over 'what the terms of the Additional Insured Endorsement require for coverage to be triggered' – the parties concede that the Policy requires a finding of negligence by Adelis." (emphasis in original). This is real dancing on the head of a pin stuff.

Just as the facts of the case and Lexington's argument were simple, so too is the moral of this story. The court concluded that the arbitration clause was narrow, because it was limited to disputes over an interpretation of the terms of the Policy and did not refer to "any and all" controversies arising under the Policy, as would be found in a broad arbitration clause.

New York Court Of Appeals: Number Of Occurrences

The Real Reason Why Roman Catholic Diocese Is Significant

You would expect the New York Court of Appeals's decision in Roman Catholic Diocese of Brooklyn v. National Union (N.Y. May 7, 2013) to get attention, as it has. The New York Court of Appeals is, well, the New York Court of Appeals. And number of occurrences is a hugely important issue. And that the case involves priest sexual abuse claims, which have resulted in some coverage questions, is also cause for the decision's high profile.

For all of these reasons I believe that Roman Catholic Diocese is worthy of attention. But the real reason why the decision is significant is one that I have not seen discussed. More about this below.

At issue was coverage for Roman Catholic Diocese of Brooklyn for a $2 million settlement of a priest sexual abuse claim. The abuse of a minor female took place from 1996 to 2002, on several occasions and at several locations. There were one year primary commercial general liability policies issued to the Diocese spanning the period of the abuse. At issue was coverage under two National Union policies that provided a $750,000 limit of liability over a $250,000 self insured retention.

The competing arguments were just as you would expect to see. National Union sought "an order that the incidents of sexual abuse in the underlying action constituted a separate occurrence in each of the seven implicated policy periods, and required the exhaustion of a separate $250,000 SIR for each occurrence covered under a policy from which the Diocese sought coverage. . . . In opposition, the Diocese argued that the sexual abuse constituted a single occurrence requiring the exhaustion of only one SIR[.]"

The court sided with the insurer, concluding that the Diocese must exhaust the SIR for each occurrence that takes place within each triggered policy. The decision is not all together surprising, based on the manner in which New York law determines number of occurrences – the unfortunate event test. "[T]he unfortunate event test requires consideration of 'whether there is a close temporal and spatial relationship between the incidents giving rise to injury or loss, and whether the incidents can be viewed as part of the same causal continuum, without intervening agents or factors.'"

Applying the unfortunate event test, the court held that "the incidents of sexual abuse within the underlying action constituted multiple occurrences. Clearly, incidents of sexual abuse that spanned a six-year period and transpired in multiple locations lack the requisite temporal and spatial closeness to join the incidents. . . . While the incidents share an identity of actors, it cannot be said that an instance

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New York Court Of Appeals:

- *Continued*

of sexual abuse that took place in the rectory of the church in 1995 shares the same temporal and spatial characteristics as one that occurred in 2002 in, for example, the priest's automobile."

On a related issue – important, but not for purposes of discussion here – the court held that pro-rata allocation applied: "[A]ssuming that the minor plaintiff suffered 'bodily injury' in each policy year, it would be consistent to allocate liability across all implicated policies, rather than holding a single insurer liable for harm suffered in years covered by other successive policies."

Roman Catholic Diocese is like so many others that have addressed number of occurrences. A finding of multiple occurrences is helpful to an insurer when the question at issue is number of deductibles or SIRs that must be applied. But when deductibles or SIRs are not at issue, but, instead, the matter at hand is number of applicable limits of liability, a finding of multiple occurrences can saddle an insurer with significant additional exposure and can be a huge win for the policyholder.

But none of this is the real reason why Roman Catholic Diocese is significant. Under these facts, and New York's existing law, the decision is not surprising. Further, the decision may not have impact in those states – and there are many like this – that have strong law in favor of finding a single occurrence in the context of multiple injuries that can be traced back to a single cause.

Roman Catholic Diocese's significance comes from the New York high court's conclusion that "sexual abuse does not fit neatly into the policies' definition of 'continuous or repeated exposure' to 'conditions'. This sounds like language designed to deal with asbestos fibers in the air, or lead-based paint on the walls, rather than with priests and choirboys. A priest is not a 'condition' but a sentient being."

This statement is significant because some courts that conclude that multiple injuries, that can be traced back to a single cause, qualify as one occurrence, sometimes rely on this continuous or repeated exposure to conditions language that usually appears in the definition of "occurrence" to reach this conclusion. But by concluding that such language is limited to asbestos fibers or lead-based paint, or presumably other similar things, the court may have enabled its decision (which is generally one that may be New York specific) to now enter into non-New York controversies, and ones involving the more frequently seen "cause" test, for purposes of determining number of occurrences.

Late-r Notice:
A Look At Decisions To Come

7th Circuit: Liquor Liability Exclusion

Brokers Take Note

I'm not one of those people (and I've seen this) that immediately comments, after an insured loses a case, that broker error somehow played a part in the finding of no coverage. I don't know enough about Netherlands Ins. Co. v. Phusion Products, Inc., No. 11-1253 (N.D. Ill. Jan. 17, 2012) to say if that's the case here. But I have always thought that the decision, that no coverage is owed, involved a curious insurance policy for the circumstances at issue. An insured, and maybe a broker, seem to have a lot riding on a Seventh Circuit appeal.

Phusion Projects produces and sells Four Loko, an alcoholic beverage that contains large amounts of caffeine and other stimulants. Phusion was named as a defendant, in five state suits, by individuals that were injured after they, or someone else, drank Four Loko. The Plaintiffs, who appear to have sustained some serious injuries, including death, alleged that "the combination of alcohol and stimulants allows drinkers to consume more alcohol without passing out, causes drinkers to behave more erratically when intoxicated, and leads to other negative health effects."

At issue was whether coverage was owed to Phusion, under a commercial general liability policy, that contained a liquor liability exclusion. One of Phusion's arguments was that it purchased insurance policies that provided insurance for injuries caused by its products, it in fact paid an additional premium to have a products limit, and the insurer knew that Phusion's only products were alcoholic beverages. Thus, Phusion argued that, if the liquor liability exclusion applied, it effectively received no coverage for its products. Phusion also argued that the liquor liability exclusion is limited to "dram shop" laws, which impose liability on those who sell alcohol directly to individuals who become intoxicated and cause injuries.

The District Court was not persuaded. It held that the liquor liability exclusion applied to all suits based on allegations that Phusion's products caused someone to become intoxicated, leading to personal injury. A defense was owed for one suit. Phusion appealed to the Seventh Circuit. Law360 reported that oral argument was held on May 14 with Phusion generally maintaining that the underlying suits claimed that the injuries were caused by the stimulants in the drink and not drunkenness from alcohol.