BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
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The "Suit" Dispute: Returning To A Courthouse Near You?

As If California Construction Defect Insurers Didn't Have Enough To Deal With

So I'm sitting on the train last night reading a just-issued California appeals court decision, eating Necco Wafers and brushing Necco Wafer dust off my pants. [And my wife says I can't do two things at once. That's three.] As I held the decision in my left hand and the Neccos in my right, it occured to me that the court's decision and the Necco Wafers had something in common. OK, work with me here.

The California decision involves a long-standing coverage issue – one that you would have thought had been put to rest long ago and offered little opportunity for anything new. But not so fast. The California appeals court found a new avenue for it – and one that it called *of first impression*. Likewise, Necco Wafers have been around since 1847. They are the steady-Eddie of candy. But despite such a longstanding run, and, also, seemingly with no opportunity for anything new, last year the Necco folks became the first national candy brand to go all natural, removing artificial colors and flavors while -- so they say -- keeping the same great taste. I nearly missed my train stop I was so intrigued by this incredible alignment of the stars.

Here is another similarity between insurance coverage and Necco Wafers – some environmental coverage cases have also been around since 1847.

The case is *Clarendon America Insurance Company v. Starnet Insurance Company*. At first it sounds like it involves a coverage issue that is very narrow and limited to a subset of California construction defect claims. But bear with me. The decision may not be so inside-baseball and, in fact, could have a much wider impact.

Putting aside the specifics of how the case developed, the appeals court addressed whether the provision in a commercial general liability policy, requiring the insurer to "defend the insured against any 'suit' seeking ... damages" to which the insurance applies, includes the duty to defend the insured in proceedings under California's Calderon Act.

"The Calderon Act requires a common interest development association to satisfy certain dispute resolution requirements with respect to the builder, developer, or general contractor before the association may file a complaint in court for construction or design defects. Although the Calderon Process occurs before a complaint is filed and itself does

not result in a judgment or court-ordered payment of money, the Calderon Process is an integral part of construction defect litigation initiated by a common interest development association." *Starnet* at 2.

In essence, the Calderon Act is a cousin to a "Right to Cure" statute that some states have adopted in an effort to stem the tide of construction defect litigation. Under these statutes, as the name implies, a developer must be given a chance to correct any construction deficiencies before suit can be filed.

The definition of "suit" in the policies at issue was as follows:

> (1) "a civil proceeding in which damages because of 'bodily injury[,'] 'property damage' or 'personal and advertising injury' to which this insurance applies are alleged"; (2) "[a]n arbitration proceeding in which such damages are claimed and to which the insured must submit or does submit with our consent"; or (3) "[a]ny other alternative dispute resolution proceeding in which such damages are claimed and to which the insured submits with our consent."

Id. at 9.

Clarendon argued that the Calderon Process falls within definition (1) of "suit" because it is a civil proceeding alleging damages to which the insurance applies. StarNet argued that the Calderon Process is not a "suit" under definition number 1 because it cannot result in a party being legally obligated to pay damages. *Id.* [The case is "insurer v. insurer."]

Not surprisingly, the *Starnet* Court turned for guidance to the Supreme Court of California's decision in *Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857. In *Foster-Gardner*, the court concluded that a "suit" is "a court proceeding initiated by the filing of a complaint." As such, the *Foster-Gardner* Court held that the insurer had no duty to defend the insured in a proceeding conducted before an administrative agency -- the Department of Toxic Substances Control, pursuant to the Carpenter-Presley-Tanner Hazardous Substance Account Act. *Id.*

On one hand, the *Starnet* Court was quick to distinguish *Foster-Gardner* on the basis that the CGL policies in *Foster-Gardner* predated the StarNet CGL policies and did not define the word "suit." On the other hand, the *Starnet* Court embraced *Foster-Gardner's* use of the "literal meaning approach" to conclude that the word "suit," without further definition, means an action initiated by a complaint. *Id*. at 10.

Applying the "literal meaning" approach, *Starnet* held that the term "civil proceeding" encompasses the Calderon Process because it is a *proceeding* created by the *Civil Code* that is required before a common interest development association may file a complaint alleging construction or design defect damages. *Id.* at 11.

The court next turned to the requirement that the StarNet CGL policies limit the duty to defend to civil proceedings "in which *damages* ... to which this insurance applies are *alleged*."
While the court noted that "damages" under the standard CGL policy is limited to money ordered by a court, it turned its attention to the word "alleged:"

> The verb "allege" has been defined to mean "to 'plead' or 'charge' matters having legal significance, or to 'accuse' or 'indict' someone in court. In defining the word "suit," the StarNet CGL policies distinguish between the words "alleged" and "claimed." The word "alleged" is used regarding damages in civil proceedings, while the word "claimed" is used regarding damages in arbitration and alternative dispute resolution. This distinction indicates the StarNet CGL policies use the word "alleged" in the formal sense meaning to plead or charge matters having legal significance.

Id. at 11-12.

From there, the *Starnet* Court went on to hold that the insurer's obligation to "defend the insured against any 'suit' seeking ... damages" to which the insurance applies, includes the duty to defend the insured in proceedings under California's Calderon Act:

> In determining whether the Calderon Process is a civil proceeding in which damages are alleged, we must consider the Calderon Process in context as one part-the first step-in a continuous litigation process. The Calderon Process is tied directly and securely to an association's complaint for damages against a builder, developer, or general contractor based on construction or design defects. The Calderon Process is mandatory: The Calderon Act prohibits an association from filing a complaint for construction or design defects until it satisfies all of the requirements of the Calderon Process. (§ 1375, subd. (a).) During the course of the Calderon Process, the association must provide "a comprehensive demand" in sufficient detail to allow for meaningful settlement discussions. (§ 1375, subd. (h)(5).) ***
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> The Calderon Process is more than a prelitigation alternative dispute resolution requirement: It is part and parcel of construction or design defect litigation initiated by an association and, as such, cannot be divorced from a subsequent complaint.

Id. at 12-13.

While the *Starnet* Court's decision is quite limited on its face, it has a two-fold, and potentially broader, significance. First, it is contrary to *Foster-Gardner*, which interpreted "suit" very narrowly. Of course, because *Starnet* distinguished *Foster-Gardner*, any comparison may be apples to oranges.

The real significance of *Starnet* is the obvious question that it leaves behind -- Will this same "suit" argument be made, and adopted, in the context of a duty to defend other pre-litigation proceedings that are not "a court proceeding initiated by the filing of a complaint" and that do not formally seek "damages."

Mandatory pre-litigation procedures arise in various contexts – not just CD -- and will no doubt only become more common as efforts to made to cut down on spawning litigation. Is *Starnet* the roadmap for insureds to follow to secure a duty to defend such pre-litigation procedures in a state where they may not have been able to otherwise?

A copy of yesterday's California Court of Appeal decision in *Clarendon America Insurance Company v. Starnet Insurance Company* can be accessed here:

http://www.courtinfo.ca.gov/opinions/documents/G042353.PDF

Please let me know if you have any questions.

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