

BINDING AUTHORITY

Insurance Coverage Decisions: Issued Today - Impact Tomorrow



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I had the privilege of writing the cover story for the Summer issue of *Wholesale Insurance News*. It addresses the disparity between states concerning coverage for construction defects, why it exists and the next phase for the issue – legislative involvement in the process. Much of the article is comprised of things that I’ve said in prior issues of *Binding Authority* and the “*Key Issues*” book, but it packages it all together. A copy of it can be accessed here (the article starts on page 8):

<http://www.nxtbook.com/nxtbooks/naylor/AMGQ0311/index.php#/2>

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Continuous Trigger: The ShamWow Of Coverage Issues – Sucking Insurers Dry Of Much More Than Would Seem Possible

Federal Court Rejects Continuous Trigger For Construction Defects

We’ve all had a waiter use a towel to hold a plate and then put it down in front of us with the warning to be careful because the plate is very hot. Of course, when he’s not looking, I always have to touch the plate. That’s construction defect coverage for insurers in California. They have full warning that there’s a real chance that they’ll get burned -- but they touch it anyway. So much so that California and construction defect have become the peas and carrots of insurance coverage.

Of course, just as I touch the plate, knowing the risk, I do not do so without taking some precaution. I limit my touch to the tip of a finger. Insurers have done the same with their California CD risk – adding endorsements to their policies that are designed to limit their risk.

Most notably, insurers have for some time been adding endorsements to their CGL policies that are designed to write-out the application of a continuous trigger – the source of so much of their trouble in the construction defect arena.

These endorsements, going by such names as First Manifestation Endorsements, Claims in Progress Exclusions, Discovered Injury or Damage Exclusions, Prior Damages Exclusions, and the like, vary in their language and scope, but are essentially designed to preclude coverage for “bodily injury” or “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 “bodily injury” or “property damage” that first takes place during the policy period.

Decisions addressing these various-named endorsements have been relatively frequent over the past few years. One observation that is impossible to miss about these decisions is how often they are *Insurer v. Insurer* litigation. It seems that when an insurer relies on one of these policy provisions to disclaim coverage, an insurer that agreed to provide a defense is none too pleased that it is being denied cost sharing on account of the co-insurer’s reliance on the provision. Consider that insurers that have advocated against the continuous trigger at least benefited from its cost sharing feature in a case where such insurer would have otherwise been left standing alone if a manifestation trigger had been applied. But these new endorsements have eliminated these cost sharing opportunities, which has brought about much litigation between insurers over their applicability.

[Incidentally, as an aside, by my observation – from recently looking at every CD coverage case nationally over the past year, for purposes of putting together the 2nd edition of “Key Issues” – trigger of coverage (not just in the context of these new endorsements) is on its way to overtaking “whether faulty workmanship is an ‘occurrence’” as the most litigated CD coverage issue.]

A couple of weeks back a California federal court issued a decision addressing a dispute between insurers over defense cost sharing for a construction defect suit. At issue was the interpretation of one insurer’s Pre-Existing Injury or Damage Exclusion. The facts of *Acceptance Insurance Co. v. American Safety Risk Retention Group* (S.D. Cal. Aug. 9, 2011) are very typical of those that have been decided in this category over the past few years.

At issue was coverage for a construction defect suit with the following timeline:

- Bay Area Construction Framers performed work at a residential development. Its work was completed in 1998.
- Bay Area was insured under CGL policies issued by Acceptance Insurance Co. from September 17, 1993 to August 15, 2000.
- Bay Area was insured under CGL policies issued by American Safety companies from August 15, 2000 to October 1, 2002.
- Acceptance Insurance defended Bay Area. American Safety disclaimed coverage.
- In 2004, Acceptance Insurance Co. settled the case for Bay Area by paying \$510,000.

Acceptance Insurance filed suit against American Safety for indemnity and contribution. At issue before the court was whether American Safety had been obligated to defend Bay Area.

American Safety maintained that it had no obligation to defend Bay Area on account of the following Pre-Existing Injury or Damage Exclusion contained in its policies:

This insurance does not apply to:

1. An “occurrence,” incident or “suit” whether known or unknown to any officer of the Named Insured:
 - a. which first occurred prior to the inception date of this policy ...; or
 - b. which is, or is alleged to be, in the process of occurring as of the inception date of this policy ..., even if the “occurrence” continues during this policy period.
2. Any damages arising out of or relating to ... “property damage” ... which are known to any officer of any insured, which are in the process of settlement, adjustment or “suit” as of the inception date of this policy....

In essence, American Safety’s argument was that the exclusion precluded coverage because any property damage had manifested prior to its policy periods. Further, American Safety argued that “even if damage were discovered during their policy periods, this was manifestation of property damage which was already in the process of occurring as of the policy inception dates, and was therefore excluded from coverage by the Pre-Existing Injury or Damage Exclusion.” *Acceptance Insurance Co. v. American Safety Risk Retention Group* at 13.

The court rejected various arguments by American Safety why it had no duty to defend, but the most notable was as follows:

The complaint and letters of findings in the Portola Action evidence a wide variety of framing defects, such as, for example, roof problems, stucco problems, and door and window problems. ... Defendants do not elaborate on the basis for their assertion that all of these defects were already in the process of occurring on every residence framed by Bay Area as of the policy inception dates. While it is generally possible for property damage to be a later manifestation of damage which was already in the process of occurring, this is not necessarily so. Defendants have provided no evidence to show or even suggest that this was the case here. They base their argument on the general proposition that because some construction defects were present at the Project as of the policy inception dates, all of the subsequently manifested damage was already in the process of occurring as of the policy inception dates. This unsupported assertion is not sufficient.

Id. at 13-14.

The court held that Acceptance Insurance, having defended Bay Area, and settling the case, was entitled to contribution from American Safety for defense and the settlement payment (with shares of allocation to be determined).

In reaching its decision, the court essentially rejected the continuous trigger by rejecting the general proposition – a convention sometimes accepted by parties out of convenience and on account of the challenges of proving otherwise – that because some construction defects were present at the Project as of the policy inception dates, all of the subsequently manifested damage was already in the process of occurring as of the policy inception dates. Rejection of this principle could result in defense obligations for insurers despite having Pre-Existing Injury or Damage Exclusions on their policies.

A copy of the Southern District of California's August 8th decision in *Acceptance Insurance Co. v. American Safety Risk Retention Group* is attached.

Please let me know if you have any questions.

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