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Truth Or Consequences: The Fifth Amendment Privilege Does Not Excuse An Insured's Failure To Submit To An Examination Under Oath

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"You have the right to remain silent. Anything you say can and will be used against you in a court of law." This ubiquitous refrain has—thanks to television and film crime dramas—become indelibly etched into America's collective psyche. But does the Fifth Amendment right to remain silent permit an insured to avoid questioning by his insurer in an examination under oath ("EUO") pursuant to his insurance policy? Pennsylvania's courts have held that although an insured is entitled to exercise his Fifth Amendment right against self-incrimination during the EUO, there may be consequences for his silence, including a denial of coverage. As it turns out, when it comes to an insurance coverage dispute, anything you **do not** say can—and likely will—be used against you in a court of law.

The Protection Afforded By the Fifth Amendment Is Not Implicated By An EUO

Standard personal property and casualty insurance policies require the insured to cooperate with his insurer in its investigation of his claim. This duty to cooperate may include the duty to submit to an EUO. The duty to cooperate—including submission to an EUO—is, therefore, a contractual obligation that exists solely because of the private contractual relationship between the insurer and the insured.

Because submission to an EUO is a contractual obligation, the Fifth Amendment privilege—the "right to remain silent"—does not apply in the context of an EUO; thus, invocation of this right will not excuse the insured from his duty to cooperate. As the California Supreme Court explained in the seminal case of *Hickman v. London Assurance Corporation*, 195 P. 45, 49 (Cal. 1920), "the compulsion secured against by the constitution is a compulsion exercised by the state in its sovereign capacity in some manner known to the law." *Id.* However, the Fifth Amendment privilege does not apply to "a private examination arising out of a contractual relationship" and existing "purely by virtue of a contract between the parties." *Id.* Therefore, an insured may not cloak himself in the protection of the Fifth Amendment during his EUO and yet still demand coverage. *See, e.g., Metlife Auto & Home v. Cunningham*, 797 N.E.2d 18, 22 (Mass. App. Ct. 2003)

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Duty to Defend Faulty Workmanship Claims Under a CGL Policy: *Indalex, Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*, 2013 PA Super 311, 83 A.3d 418, 2013 WL 6237312 (Pa. Super. 2013).

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Introduction

A recent 2013 Superior Court decision calls into question Pennsylvania's jurisprudence established by the Supreme Court less than a decade ago which relieved commercial general liability ("CGL") insurers of the burden to defend and indemnify insured contractors from faulty construction workmanship contract claims. Prior to 2006, complaints alleging claims of "faulty workmanship" or "construction defect" against an insured contractor or subcontractor often required the insurer to at least defend, if not outright indemnify, the claim, even though the law and most CGL policies exclude

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may void coverage if this failure to cooperate resulted in "substantial prejudice" to the insurer. *See, e.g., Bogatin*, 2000 U.S. Dist. LEXIS 8632, at *79; *Aetna*, 771 F. Supp. at 707. In order to show prejudice, the party conducting the EUO should therefore ask all questions material and necessary to the insurer's determination of coverage—even if the response to each is an assertion of the right to remain silent—in order to make a complete record of the insured's non-cooperation. Indeed, the insurer or its counsel would be wise to draw out this assertion of privilege as to the ultimate questions bearing on coverage, such as "Did you intentionally hit the pedestrian?"; "Did you deliberately drive your car into the building?"; "Did you intentionally set your house on fire?"; or "Did you deliberately flood your basement?"

Conclusion

The Fifth Amendment privilege against self-incrimination does not trump an insured's contractual duty under his insurance policy to cooperate with his insurer's investigation of a claim. Although the insured may properly invoke his Fifth Amendment privilege to avoid answering questions during an EUO that might incriminate him, this constitutional protection does not prevent adverse consequences for the insured for his failure to testify, including a denial of coverage. Simply put, the insured's silence during an EUO can, and likely will, be used against him by his insurer.

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coverage for claims by a customer against a contractor for breach of a contract or warranties. *See, e.g., Freestone v. New England Log Home, Inc.,* 819 A.2d 550, 553 (Pa. Super. 2003) (holding allegedly poor advice of a log home kit company to customers regarding the caulking of a log home could not be construed as an "accident" or "occurrence" under the CGL policy).

However, the Supreme Court of Pennsylvania in *Kvaerner v. Commercial Union Ins. Co.*, 589 Pa. 317, (2006) made clear that coverage is not triggered by a faulty workmanship claim. Such contractually based claims are not "occurrences" qualifying as "bodily injury" or "property damage" under the terms and conditions of a typical CGL policy. *Id*. at 335-36 (2006). Nevertheless, the Superior Court of Pennsylvania recently issued *Indalex, Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*, 83 A.3d 418 (Pa. Super. 2013), a decision carving out an exception which may force CGL insurers to defend contractors when boilerplate negligence claims are included in a complaint. The Superior Court's exception, if allowed to stand, could have the effect of completely devouring the rule that insurers are not guarantors of the quality of the work of insured contractors, at least with respect to the duty to defend the contractors.

Development of the Law and Precedents

A. Kvaerner v. Commercial Union Insurance Company ("Kvaerner")

In this landmark case, the Supreme Court of Pennsylvania held that faulty workmanship claims do not establish an "occurrence" under insurance policies because such claims do not present the degree of fortuity contemplated by the ordinary or judicially constructed definitions of "accident."

Kvaerner Metals Division of U.S., Inc. ("Kvaerner") was an insured builder of coke oven batteries for use in commercial ovens. Kvaerner faced underlying breach of contract and breach of warranty claims alleging that its product damaged the ovens in the facilities. *Id*. at 321-322. The insurance carrier would not defend or indemnify when it concluded the claims did not fall within the coverage provisions of the CGL policies because, *inter alia*, the incidents did not constitute an occurrence. *Id*. at 323-24.

Kvaerner reinforced the overarching rule that an insurer's duties to defend and indemnify the insured depend on a third party's complaint. More specifically, the key is whether the factual averments and language of the complaint against the insured defendant trigger coverage. *Kvaerner*, 589 Pa. 329-30 (internal citations omitted).

The key *Kvaerner* determination is whether the underlying damage was caused by an "accident" so as to constitute an "occurrence" under the policy. *Id*. at 332. An "accident" involves something "unexpected," which implies a degree of fortuity not present in a claim for faulty workmanship. *Id*. at 333, 335-36. The *Kvaerner* court was unwilling to consider faulty workmanship as an "occurrence," lest it turned an insurance policy into a performance bond insuring quality construction. *Id*. at 336.

B. Millers Capital Insurance Co. v. Gambone Brothers Development Co. ("Gambone")

The Superior Court of Pennsylvania encountered a similar fact pattern and issue in 2007 and followed the precedent set in *Kvaerner* by holding that an "occurrence" refers to "accidental" happenings and not faulty workmanship allegations. *Millers Capital Insurance Co. v. Gambone Brothers Development Co.*, 941 A.2d 706, 718 (Pa. Super. 2007).

Gambone involved a real estate firm ("Gambone") that had planned, designed, and built a home development. *Id*. at 708. Two sets of complaints were brought against Gambone alleging faulty workmanship. *Id*. at 714. The first alleged water leaks in homes which were the result of "construction defects and product failures." The second involved the use of defective stucco in building the houses. *Id*. at 709. The claims were for breach of contract, breach of warranty, negligence, strict liability,

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fraud and misrepresentation, negligent misrepresentation, and violations of the Unfair Trade Practice and Consumer Protection Law. *Id*. at 709-10. Millers Capital Insurance Co.'s ("Millers") CGL policies covered bodily injury and property damage caused by an "occurrence," which was defined by the policy as "an accident including continuous or repeated exposure to substantially the same general harmful conditions." *Gambone*, 941 A.2d at 711. The insured attempted to distinguish this fact pattern from *Kvaerner* by arguing that the claims were not merely alleging faulty workmanship, but also accidental and ancillary damage caused by the water leaks to non-defective property within the home interiors. *Id*. at 713. The court found the claims were all based on faulty workmanship. Also, damage from rainfall seeping through a faulty home exterior is not considered sufficiently fortuitous to constitute an occurrence or accident triggering coverage. *Id*. at 713-14.

C. Erie Insurance Exchange v. Abbott Furnace Company ("Abbott")

The Superior Court of Pennsylvania applied the "gist of the action" doctrine to an underlying complaint involving a similar fact pattern, relieving a CGL insurer from the burden of providing coverage. *Erie Insurance Exchange v. Abbott Furnace Company*, 972 A.2d 1232 (Pa. Super. 2009).

Abbott involved an annealing furnace manufacturer who had contractually entered into an agreement with a commercial magnetic manufacturer to provide annealing furnaces. The annealing furnaces were allegedly defective and became damaged. The furnaces also damaged the customer's own products (i.e. laminations). *Id*. at 1234-35. The legal theories for the underlying litigation included breach of contract, breach of warranty, breach of duty of good faith and fair dealing, and fraud. *Id*.

The insurer, Erie Insurance Exchange ("Erie"), argued there was no occurrence because all of the claims in the underlying litigation stemmed from the alleged breach of contract. *Id*. at 1237. Therefore, there was no trigger of the policy to defend/indemnify the manufacturer. The manufacturer countered that the underlying complaint also alleged a negligence claim in addition to faulty workmanship and damage to the furnace. *Id*. at 1237.

The *Abbott* court starts from the *Kvaerner* proposition that contractual claims of faulty workmanship do not constitute the active malfunction needed to trigger coverage under a CGL policy. *Abbott*, 972 A.2d at 1238. The key was whether the complaint pled a negligence claim alleging the furnace actively malfunctioned and caused destruction and damage to the underlying plaintiff's personal property (i.e. laminations). If so, then the claims would be covered under the general liability policy. *Id*. at 1237-38.

The "gist of the action" doctrine is at play when making this determination. "When a plaintiff alleges that the defendant committed a tort in the course of carrying out a contractual agreement, Pennsylvania courts must examine the claim and determine whether the 'gist' or graveman of it sounds in contract or tort." *Id*. at 1238 (citing *Mfrs.' Ass'n Ins. Co. v. L.B. Smith, Inc.*, 831 A.2d 1178, 1182 (Pa. Super. 2003)). It is important to look at the nature of the action as a whole. The difference between a breach of contract claim and a tort claim is that the former arises out of a breach of duties imposed upon individuals by a contract, while the latter arises out of breach of duties imposed by law as a matter of social policy. *Id*. (citing *Reardon v. Allegheny College*, 926 A.2d 477, 486-87 (Pa. Super. 2007)). Practically, the doctrine precludes recasting ordinary breach of contract claims into tort claims. *Abbott*, 972 A.2d at 1238 (internal citations omitted). The gist of the action doctrine precludes a tort claim when said claim

> (1) [arises] solely from the contractual relationship between the parties; (2) when the alleged duties breached were grounded in the contract itself; (3) where any liability stems from the contract; and (4) when the tort claim essentially duplicates the breach of contract claim or where the success of the tort claim is dependent on the success of the breach of contract claim.

Reardon v. Allegheny College, 926 A.2d 477, 486-87 (Pa. Super. 2007) (internal citations omitted).

The court found that the negligence claim was not adequately pled in the underlying complaint. The "gist" of the action was not in tort and was properly limited to a contract claim because the parties' obligations arose from an agreement rather than from larger social policies. *Id*. at 1239.

With these three cases as background, the Pennsylvania Superior Court recently again confronted this issue.

***Indalex, Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*, 2013 PA Super 311, 83 A.3d 418 (Pa. Super. 2013).**

Facts and Procedural History of *Indalex*

Appellants Indalex Inc. and Harland Clarke Holdings Corp. (collectively "Insured") filed an Allegheny County Court of Common Pleas action against Appellee National Union Fire Insurance Co. of Pittsburgh, PA ("NUFI"). *Indalex*, 83 A.3d at 419. Appellants sought indemnification under a commercial umbrella policy for multiple out-of-state, underlying lawsuits filed by homeowners and property owners claiming that Insured's windows and doors were defectively designed or manufactured, resulting in water leakage. *Id*. The water leakage allegedly caused physical damage (e.g. mold, cracked walls) and personal injuries. *Id*. at 419-420. The out-of-state claims against Indalex were based on negligence, breach of warranty, strict liability, and breach of contract. *Id*. at 420.

Appellee NUFI did not believe it was required to defend because there was no "occurrence" triggering coverage under Pennsylvania law. *Id*. There were a few key clauses in the policy which were relevant for the purposes of resolving this issue. First, NUFI was obligated to provide coverage for "liability imposed by law or assumed by the Insured under an Insured Contract because of Bodily

Injury, Property Damage, Personal Injury, or Advertising Injury that takes place during [the] Policy Period and is caused by an *occurrence* happening anywhere in the world." *Indalex*, 83 A.3d at 421. (emphasis added). The major dispute was over the meaning of "occurrence" in the policy. The policy has two definitions of "occurrence":

> 1. As respects Bodily Injury or Property Damage, an accident, including continuous or repeated exposure to conditions, which results in Bodily Injury or Property Damage *neither expected nor intended from the standpoint of the Insured*. All such exposure to substantially the same general conditions shall be considered as arising out of one Occurrence;
>
> 2. As respects Personal Injury, an offense arising out of your business that results in Personal Injury. All damages that arise from the same or related injurious material or act shall be considered as arising out of one Occurrence, regardless of the frequency or repetition thereof, the number and kind of media used and the number of claimants[.]

Id. at 421-22 (emphasis added).

The policy also provided a separate $25 million aggregate limit of liability for a "Products-Completed Operations Hazard," including "all Bodily Injury and Property Damage occurring away from premises you own or rent and arising out of Your Product or Work Scope." *Id*. at 421. Further, "Property damage *in your* product" is excluded. *Id*. (emphasis original). The definition of "Your Product" includes all of the insured's "goods or products" and related "[w]arranties or representations . . . with respect to the fitness, quality, durability, performance or use." *Id*. Covered property damage includes "[p]hysical injury to tangible property, including all resulting loss of use" and "[l]oss of use of tangible property that is not physically injured." *Indalex*, 83 A.3d at 421.

The trial court agreed that *Kvaerner* barred coverage and granted summary judgment to NUFI. *Id*. at 422. The lower court determined that the language in NUFI's umbrella policy was almost identical to the policy language at issue in *Kvaerner*. *Id*. at 424.

On appeal, the main issue was whether NUFI had an obligation to defend or indemnify under the terms and conditions of the commercial umbrella policy issued by NUFI. There were three interrelated sub-issues that needed to be addressed in order to resolve the main question.

1) Was it proper to characterize the underlying lawsuits as involving "faulty workmanship" and thus not an "occurrence" as defined in the policy?

2) Did the underlying lawsuits plead tort-based products liability claims involving property damage other than the doors and windows, therefore deserving coverage under the policy when read as a whole?

3) Did the trial court improperly rely on Pennsylvania's "gist of the action" doctrine to ignore legally viable tort claims against product manufacturers, triggering a duty to defend?
Id. at 420.

Discussion

The Superior Court reversed the trial court and concluded there was an "occurrence" requiring NUFI to defend the Insured. First, the court went about distinguishing *Indalex* from *Kvaerner*, *Gambone*, and *Abbott*, *supra*.

In *Gambone*, the "product" itself was the home and the issue was framed as faulty workmanship in applying stucco and other items. Even though *Indalex,* like *Gambone,* involved water leaks, the product at issue in *Indalex* was limited to the windows and doors only. Therefore, the damage to the walls of the house did not involve Indalex's product. *Indalex*, 83 A.3d at 420.

The court distinguished the *Kvaerner* holding as being limited to situations "where the underlying claims were for breach of contract and breach of warranty, and the only damages were to the [insured's] work product." *Id*. The language in the NUFI CGL policy was distinguishable with the CGL policy language in *Kvaerner*. The *Indalex* CGL policy defined an "occurrence" as an accident—"including continuous or repeated exposure to neither conditions—which was *expected nor intended from the standpoint of the Insured*." *Id*. at 424-25 (emphasis in original). *Kvaerner* did not contain subjectivity in its definition of occurrence. Moreover, a key term of the ordinary definition of "accident" is unexpected. From the Insured's subjective viewpoint, the alleged damages involving mold-related health issues were arguably unexpected. Therefore, the court highlighted this as an important distinguishing feature from *Kvaerner*.

The *Indalex* opinion stresses that an insurer is obligated to defend its insured whenever an injured party's complaint may potentially fall within the policy's coverage. *Id*. (citing *American States Ins. Co. v. Maryland Casualty Company*, 628 A.2d 880, 887 (Pa. Super. 1993)). The *Indalex* court construed the NUFI policy in such a way as to give effect to all of its language and concluded NUFI was obligated to defend appellants. *Indalex*, 83 A.3d at 425. The claims in the underlying complaint were based on damages to person or property (i.e. mold and cracked walls) other than Insured's doors and windows.

The court also focused on distinguishing its previous decision in *Abbott* in which the court applied the "gist of the action" doctrine in reaching its decision. The court did so by stating that in *Abbott* the "gist of the action" doctrine was applicable because the negligence claim was not adequately pled in the underlying complaint. *Id*. The court in this case rejected preclusion on the "gist of the action" doctrine purportedly because the doctrine has not been adopted by the Supreme Court of Pennsylvania in an insurance coverage context. Therefore, the Superior Court chose not to apply the doctrine to bar the negligence claims. *Id*. However, multiple federal opinions have applied the doctrine when interpreting Pennsylvania law on similar issues. *See: Meridian Mut. Ins. Co. v. James Gilligan Builders*, 2009 WL 1704474 (E.D. Pa. June 18, 2009) (holding that under the "gist of the action" doctrine, a contractually based claim against a home-improvement contractor could not be recast as a tort claim for the purposes of establishing an occurrence

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and triggering coverage under a policy); *see, also, Transportation Ins. Co. v. C.F. Bordo*, 2009 U.S. Dist. LEXIS 27266 (M.D. Pa., March 30, 2009).

Since the duty to defend is broader than the duty to indemnify and applicable for a potentially covered claim, *Indalex* found the "gist of the action" doctrine would be inconsistent if applied in this context. *Indalex*, 83 A.3d at 426. The court distinguished the *Abbott* application of the doctrine. The alleged duties breached in *Abbott* arose from an express underlying contractual agreement rather than from tort duties imposed by public policy. *Id*. at 426, n 3. The court also noted that when tort claims are among a litany of different causes of action, they must be considered. *Id*. (citing *National Fire Ins. Co. of Hartford v. Robinson Fans Holdings, Inc.*, 2011 WL 1327435 (W.D. Pa. 2011) (insurer must defend a multiple cause of action complaint until the claim(s) excluded from the scope of the policy can be isolated)). Based on these reasons, *Indalex* rejected application of the doctrine.

In sum, because the underlying claims alleged defective products resulting in personal injury and property loss not involving Insured's products, there was an "occurrence" triggering coverage under the commercial umbrella policy.

Analysis and Conclusion

Indalex certainly bucked the trend in Pennsylvania case law on the issue of whether commercial general liability insurers are relieved from defending and indemnifying contractually based construction defect claims pled as negligence allegations. *Kvaerner* is still the controlling precedent on the issue. However, *Indalex* has carved out some big exceptions worth noting.

One important distinction is policy language defining occurrence in a way that relies on the insured's subjective expectations or intentions. *Indalex* found this distinction critical because unexpected adverse happenings are more likely to be "accidental" when applying an ordinary definition to the term. Any CGL policies containing similar language may subject the insurer to liability under a similar fact pattern. Notably, *Gambone* involved a similar fact pattern with home water damage, but the *Indalex* court read the case as viewing the whole house as the "product" because the insured was building home developments. In this case, the product was narrowly construed to be just the doors and windows of the house. The damage, moldy walls, was "other property." This is an important distinction because the property alleged to be damaged in an underlying complaint becomes important in determining if coverage is triggered.

The *Indalex* court makes a significant departure from its previous holding in *Abbott* in applying the gist of the action doctrine. While there is an attempt to distinguish *Abbott* on the adequacy of the negligence pleading in that case, *Indalex* also suggests the gist of the action doctrine is not applicable in determining if a duty to defend is triggered as a matter of law. The court was persuaded by *National Fire Ins. Co.*, *supra*, that a trial court's presiding over the underlying action, should examine and apply the gist of the action doctrine to specific claims in the underlying complaint. The application is fact-specific and dependant on the law of the underlying jurisdiction. This case-by-case approach creates uncertainty for CGL insurers moving forward.

Indalex did not disturb the case law on whether a duty to defend or indemnify arises for underlying claims of faulty workmanship and damage to the manufacturer's *own* product. *Kvaerner* was buttressed by *Indalex* on this point regardless of how a claim is dressed. However, if the property allegedly damaged is not that of the insured's, then *Indalex* has seemingly opened the door to trigger coverage under a CGL policy with underlying contractual causes of action dressed as negligence claims. The split within the Superior Court may require the Supreme Court of Pennsylvania to clarify the issue in the future.

Until the Supreme Court addresses the issue, insurers must be aware that a well plead negligence claim may at least trigger the duty to defend a contractor in a faulty workmanship/ construction defect case. And if the carrier decides that the negligence claim is not well pled and there is diversity of citizenship, the carrier should consider moving forth with a declaratory judgment action in federal court and avail itself of the use of the "gist of the action" doctrine.