BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
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Coverage College Flunkie: Me

Last Second Decisions Change the Score for Duty to Defend and the "Occurrence" Issue

On Thursday I stood at the podium at the White and Williams Coverage College [where, by the way, a good time was had by all] and discussed, among other things, the use of extrinsic evidence to determine the duty to defend and whether faulty workmanship is an "occurrence." I concluded that, by my count, 35 states allow for the use of extrinsic evidence, in some way, shape or form, to determine the duty to defend. Err, make that 36. It turns out that, on Wednesday, as I was busy doing final preparations for my next day's presentation, an Oregon appellate court was busy messing up said presentation. The court issued a decision that created an exception to the state's "four corners" rule to allow for the use of extrinsic evidence to create a duty to defend. Thanks guys.

I also stated during my presentation that the score on the "occurrence" issue is 27 states that have concluded that faulty workmanship is an "occurrence," and 20 that have concluded that it is not. Well, um, actually, the score is 28-19. On Thursday, perhaps at the very moment that I was giving my presentation, the Indiana Supreme Court also had it out for me. The court issued its much anticipated decision in *Sheehan Construction* and held that faulty workmanship constitutes an "occurrence." I had Indiana in the other camp based on its earlier decisions (albeit decided on a no "property damage" rationale – but that's akin to no "occurrence" for scorekeeping purposes). And they couldn't have said that a week earlier?

[Thankfully I have tenure at the Coverage College. So I'm not too worried about this.]

On a serious note… Having two decisions come down within hours of my presentation, that were directly relevant to it, was a strange coincidence indeed. But what's not strange is evidence that the coverage landscape and scoreboard are in a constant state of flux.

As the impact of *Sheehan Construction Company, Inc. v. Continental Casualty Co.* is limited to Indiana, I will not address it here. For those interested in the Indiana Supreme Court's Sept. 30 decision, where the court held that it was aligning itself "with those jurisdictions adopting the view that improper or faulty workmanship does constitute

an accident so long as the resulting damage is an event that occurs without expectation or foresight," click here:

http://www.in.gov/judiciary/opinions/pdf/09301001rdr.pdf

While Sheehan's impact is limited to its home state, the Oregon appellate court's duty to defend decision offers lessons nationally. So that one is worthwhile to discuss.

In *Shearer & Sons v. Gemini Ins. Co.*, the Court of Appeals of Oregon addressed coverage under the following circumstances. Fred Shearer & Sons was a stucco installer on a residential project that had become the subject of a construction defect action. Shearer was named as a third-party defendant by Walsh, the general contractor. Shearer sought coverage for the suit under a vendor's endorsement on a policy issued by Gemini Ins. Co. to TransMineral, USA, a distributor of the stucco product. Shearer had been operating under an "Exclusive Applicator Agreement" with TransMineral.

The vendor's endorsement provided coverage to "all vendors of [TransMineral]," but "only with respect to 'bodily injury' or 'property damage' arising out of 'your products' * * * which are distributed or sold in the regular course of the vendor's business." ***Fred Shearer* at 3.**

Gemini rejected Shearer's tender and Shearer filed a declaratory judgment action. Shearer filed a motion for summary judgment and the trial court granted it.

On appeal Gemini's argument was as follows: Gemini did not appear to contest the fact that Shearer, pursuant to its Exclusive Applicator Agreement with TransMineral, was a "distributor" of TransMineral products, including the Lé Decor product used on the residence at issue. Rather, Gemini argued that, looking at the four corners of the complaint and policy – which exclusively govern whether Gemini owes any duty to defend -- nothing in the general contractor's allegations expressly or impliedly indicated that Shearer "distributed" or "sold" the TransMineral products. In light of that deficiency in the underlying pleadings, Gemini argued that the trial court erred in granting summary judgment in favor of Shearer. *Id.* at 4.

By all accounts (and the parties agreed) Oregon is a "four corners" state. It seems like it would have been difficult to reach any other conclusion based on *Ledford v. Gutoski*, 877 P.2d 80 (Or. 1994), where the Oregon Supreme Court made various strong pronouncements that, for purposes of determining the duty to defend, all that matters are the allegations in the complaint.

But the Oregon appellate court was quick to distinguish *Ledford*:

"Certain parts of that passage [from *Ledford* and addressing strong support for the four corners rule], read in isolation, support Gemini's contention that the duty to defend is determined solely by facts alleged in the underlying complaint. However, it is important to understand what was at issue in *Ledford*--and what was not. The question in *Ledford* was whether the complaint could 'impose liability for *conduct* covered by the policy.'

The court was not concerned with the preliminary question: whether the party seeking coverage was actually an *insured* within the meaning of the policy. Rather, *Ledford*--and, to our knowledge, every other case in which Oregon appellate courts have held that their inquiry was limited to the facts of the underlying complaint--presumed the existence of an 'insured' within the meaning of the policy." ***Id.* at 5 (citations omitted).**

"The *Shearer* court concluded that, "[w]hen the question is whether the insured is being held liable for conduct that falls within the scope of a policy, it makes sense to look exclusively to the underlying complaint." *Id.* at 6. In this situation, the four corners rule prevents the insurer from having to take note of facts other than those alleged, which would require the insured to speculate upon whether the facts alleged could be proved.

However, the court concluded that such rule was not applicable to the instant matter: "The same cannot be said with respect to whether a party seeking coverage is an 'insured.' The facts relevant to an insured's relationship with its insurer may or may not be relevant to the merits of the plaintiff's case in the underlying litigation. The plaintiff in the underlying case is required to plead facts that establish the defendant's liability; the plaintiff often is not required to establish the nature of the defendant's relationship to some other party or to an insurance company in order to prove a claim. In this case, for example, the Evenstads [underlying plaintiff] had no reason to allege that Shearer sold or distributed TransMineral's products in the ordinary course of its business; nor did Walsh need to allege that fact in order to make out its third-party claim against Shearer. For that reason, we do not see the logic in requiring Shearer to demonstrate that the underlying complaints establish the relationship between TransMineral and Shearer, or, consequently, that Shearer is Gemini's 'insured' within the meaning of the policy." *Id.*

With its decision in *Shearer*, the Oregon appeals court appears to have placed itself in the duty to defend camp that allows for consideration of extrinsic evidence that is relevant to a coverage issue, so long as it does not impact the liability issues in the underlying action. Oregon is not alone in treating the duty to "defend/extrinsic evidence" issue in this matter – allowing extrinsic facts that are relevant to the issue of coverage, but that do not affect the third party's right of recovery.

A copy of the September 29 Oregon Appeals Court decision in *Shearer & Sons v. Gemini Ins. Co.* can be accessed here:

http://www.publications.ojd.state.or.us/A136818.htm

Please let me know if you have any questions.

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