MEALEY'S™ LITIGATION REPORT

Insurance

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Faulty Work Question Certified To Wisconsin High Court

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Absolute Clause Does Not Apply To Heating Oil Spill

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Panel Finds Conflict Of Interest, Right To Independent Counsel

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Withdrawal Of Defense Justified; Insurer May Rely Consent Clause

RALEIGH, N.C. — An insurer's withdrawal of its defense following a favorable decision on the pollution exclusion was justified and was not a breach of contract; thus, it may rely on its defense that the insured settled with claimants without its consent, a North Carolina judge held Feb. 7. **SEE PAGE 8.**

Judge Allows Contribution Claim Between Primaries, Not Against Excess

SAN FRANCISCO — A portion of an equitable contribution claim is viable as pertaining to contribution between primary insurers that insured a builder who tendered a construction defect lawsuit, a California federal judge held Jan. 19.

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Ohio State Court To Determine Dryvit EIFS Claims Coverage

CINCINNATI — An Ohio state court will determine whether coverage is owed under certain excess liability policies for damages resulting from Dryvit Systems Inc.'s defective synthetic stucco, according to a federal judge's Feb. 9 dismissal of a parallel action.

Construction Defects
P. 13

Home Liquidator's Suit To Recover Defense Costs Dismissed

CONCORD, N.H. — A New Hampshire judge on Feb. 13 dismissed a suit brought by The Home Insurance Co.'s liquidator against an insured to recover costs spent in defense of treated wood litigation.

Liquidation
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Insurance

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Question As To 'Occurrence' From Faulty Work Certified To Wisconsin Supreme Court

MADISON, Wis. — A Wisconsin appellate panel on Feb. 9 certified to the Wisconsin Supreme Court the question of whether an "occurrence" was involved in a subcontractor's faulty work and the application of the high court's 2004 decision in American Family Mutual Insurance Co. v. American Girl Inc. (673 N.W.2d 65 [Wis.], *recons. denied*, 679 N.W.2d 548 [2004]; See 1/13/04, Page 3) (Glendenning's Limestone & Ready-Mix Company Inc. v. Michael A. Reimer, et al., No. 2005AP1092, Wis. App., Dist. IV).

(**Opinion in Section A.** Document #03-060221-101Z.)

Concrete Work

Michael Reimer was hired to provide construction services to a dairy facility. One of the subcontractors hired by Reimer negligently performed concrete work, resulting in 1,450 cow stalls with an inadequate slope for waste drainage. A suit filed by the owners also alleges that stall loops and neck bars turned out irregular and inconsistent.

Reimer's insurer, West Bend Mutual Insurance Co., commenced a declaratory judgment action as to its obligation to provide coverage. The Lafayette County Circuit Court granted summary judgment to West Bend. The property owners appealed.

Resolving the issue of whether there was an "occurrence" at the facility requires interpretation and application of American Girl, the District IV Court of Appeals said.

The American Girl court ruled that there was an "occurrence" under the terms of a commercial general liability policy when a subcontractor provided faulty soil/site preparation consulting services that contributed to structural damage.

Although this case does not concern the breach of warranty/breach of contract aspect involved in American Girl, the high court's discussion of the term "accident" is directly related to the present case, the appeals court said.

Expected, Intended

The high court found that the cause of the damage and the resulting harm in American Girl was neither expected nor intended, placing the incident within the policy's definition of "occurrence." The dairy facility owners here contend that the damage to their facility was also accidental because it was not intentional or anticipated. However, West Bend argues that American Girl is distinguishable because the owners don't allege accidental *conduct* by the subcontractor, only an accidental *result*. It cites one of the dictionary definitions relied on in American Girl, stating that a "result, though unexpected, is not an accident; the means or cause must be accidental."

The intermediate appellate court said, "In short, we see the dispositive issue as this: should *American Girl* be read broadly to mean that all faulty work by subcontractors is an occurrence? Or, should it be read more narrowly to say that negligence by subcontractors can be an occurrence under some circumstances? And, if subcontractor negligence is an occurrence under only certain circumstances, what are the analytical tools or definitions that will enable courts, litigants, and parties to proposed insurance contracts to reliably and consistently determine whether particular circumstances qualify as occurrences?"

Clarence F. Asmus of Brennan, Steil & Basting in Monroe, Wis., and Margery M. Tibbetts of the firm's Janesville, Wis., office represent the dairy owners. Robert S. Duxstad of Duxstad, Vale & Bestul in Mon-

roe represents Glendenning's Limestone & Ready-Mix Company Inc. Rick J. Mundt of Winner, Wixson & Pernitz in Madison is the attorney for the insurer. ■

Absolute Clause Does Not Apply To Heating Oil Spill; Defense Owed To Installer

WORCESTER, Mass. — A commercial general liability policy's total pollution exclusion does not preclude the duty to defend an installer of heating equipment from which oil eventually leaked into soil, a Massachusetts judge ruled Dec. 15 (Thomas McGregor v. Allamerica Insurance Co., No. WOC04-1001, Mass. Super.; 2005 Mass. Super. LEXIS 636).

(**Opinion in Section D.** Document #03-060221-104Z.)

No Industrial Context

The discharge of oil in this case was not in the industrial context or from the insured's industrial operations, but from a broken oil burner, Worcester Superior Court Judge Leila R. Kern said. A reasonable insured reading the exclusionary language would not expect coverage to be denied for damages caused by a broken oil burner, she added.

"In the instant case, the leak in the oil burner was an isolated accident, in a private residence, that arose during the course of [Thomas] McGregor's normal business activities. The damages resulted from McGregor's activities 'gone slightly, but not surprisingly, awry,'" she said, referencing the Massachusetts Supreme Judicial Court's remark in Western Alliance Ins. Co. v. Gill (426 Mass. 115, 120-21, 686 N.E.2d 997 [1997]; See 11/18/97, Page 4).

Cleanup Costs

McGregor was sued in connection with his installation of a new oil burner and heating system in the home of Peter and Susan Staecker in December 1994. In February 2001, the Staeckers discovered a leak in the oil supply line, causing contents of the supply tank to run into the ground. The Massachusetts Department of Environmental Protection required the Staeckers to perform an assessment and remediation of the contamination.

As subrogees, the Staeckers' insurers sued McGregor, seeking to recover cleanup costs. McGregor's liability insurer, Allamerica Insurance Co., refused to defend it in that suit based on the total pollution exclusion in the 2000-01 policy issued to McGregor.

Case Law

Judge Kern cited decisions of the Supreme Judicial Court holding that the pollution exclusion did not apply to a child's lead poisoning or injury arising from exposure to carbon monoxide.

Ultimately, she relied on a Superior Court decision involving a similar factual scenario in Eastern Casualty Insurance Co. v. The Home Store Inc. (Civil No. 5323 [Middlesex Super. Ct., 5/20/05] [Gailey, J.] [19 Mass. L. Rptr. 363]; 2005 Mass. Super. LEXIS 252; See 6/28/05, Page 5).

The Home Store court emphasized the context in which the damages occur with respect to the application of the total pollution exclusion and ruled that an objectively reasonable insured reading the language of the exclusion would not expect to be denied coverage for damages caused by a broken home furnace. ■

5th Circuit Remands For Determination On Consent, Breach, Prejudice Findings

NEW ORLEANS — The Fifth Circuit U.S. Court of Appeals on Feb. 6 ruled that an insurer offering a defense with a reservation of rights can enforce a consent to settle provision and remanded for a determination on whether Motiva Enterprises LLC breached its policy by failing to obtain consent to an underlying settlement relating to a refinery explosion and whether its insurer was prejudiced (Motiva Enterprises LLC v. St. Paul Fire and Marine Insurance Co., et al., No. 05-20139, 5th Cir.; 2006 U.S. App. LEXIS 2880; See 10/26/04, Page 6).

(**Opinion in Section C.** Document #03-060221-103Z.)

At issue is coverage under an excess policy issued by National Union Fire Insurance Company of Pittsburgh, Pa. Motiva contends that it was not obligated

to obtain consent before settling the underlying action because National Union refused to tender an unqualified defense.

Tank Explosion

Motiva was sued after an explosion of a sulfuric acid tank at a Motiva refinery in Delaware, which killed one and injured several employees of a contractor hired by Motiva.

National Union provided $25 million of umbrella coverage above a $5 million policy issued by St. Paul Fire and Marine Insurance Co. The policy contained standard "consent to settle" and "cooperation" clauses.

National Union refused coverage until St. Paul's insurance was exhausted. National Union then issued a reservation of rights letter and agreed to investigate underlying insurance and if intentional acts by Motiva caused the explosion. Motiva later informed National Union that the St. Paul policy had been exhausted in contributing toward a $36 million settlement with the estate of the deceased worker.

Settlement Demand

With respect to another employee's injuries, Motiva received a settlement demand for $40 million. Motiva refused to comply with National Union's request to provide all documents related to the ensuing lawsuit, including a description of the injuries, the potential loss and Motiva's evaluation of the claim, claiming that National Union had not officially agreed to defend. Motiva demanded that a National Union representative attend the mediation of the suit.

National Union agreed to defend the remaining cases under a reservation of rights. Motiva still refused to share documents with National Union. In the mediation, Motiva asked National Union to leave before it was finished. Thereafter, Motiva settled the claim for $16.5 million without the insurer's consent.

In October 2004, U.S. Judge Lynn N. Hughes of the Southern District of Texas ruled that National Union is not obligated to indemnify Motiva's settlement because it failed to obtain the insurer's consent or to cooperate.

Cooperation

"Motiva was not unprotected because the National Union policy was unavailable. It had almost $200 million in other coverage. It also sought a declaration that its policy with National Union covered the claims from the explosion. Instead of prosecuting, it settled the [underlying] case without National Union's consent, knowing that the policy required consent," he explained.

Furthermore, Motiva is not an unsophisticated insured, he said, but is a subsidiary of a huge international company with a complex and expensive insurance program. It knows how umbrella policies operate, he said. National Union's actions did not grant Motiva the right to disregard the policy's requirements, he added.

It did not have the right to settle based on National Union's initial denial of coverage because the insurer revised its position before the mediation of the settlement at issue, he said. Regardless, between the denial and the settlement, Motiva involved National Union in its defense.

"If it did not want to accept National Union's qualified defense, it should have rejected it immediately and not have told National Union to attend the mediation," he said.

Motiva breached its duty to cooperate by asking National Union to leave the mediation and settling the claim without National Union's consent before it rejected the tender of defense, Judge Hughes held.

Inconclusive Evidence

The Fifth Circuit concluded that under current case law, an insurer that tenders a defense under a reservation of rights is entitled to enforce a consent to settle clause. But the fact that Motiva asked National Union to leave the mediation is not enough to conclude that Motiva breached the cooperation clause, it said. There is not sufficient evidence in the record regarding that request, only a subsequent letter stat-

ing that the insurer was "brashly asked" to leave the mediation. There isn't enough information about the significance of that event in terms of the outcome of the case and whether it prejudiced National Union, it said.

Ultimately, it ruled that even if Motiva breached the clauses, National Union can't refuse proceeds unless it demonstrates prejudice from the breach. Thus, it remanded the matter to the District Court for a determination of whether Motiva breached the cooperation clause, and whether National Union suffered actual prejudice from Motiva's breach of any policy condition.

Robert M. Roach of Cook & Roach in Houston and William T. Hankinson, Katherine D Varholak and Christopher R Moseley of Sherman & Howard in Denver represent Motiva. Jeffrey R. Parsons and Stephen B. Edmundson of Beirne Maynard & Parsons in Houston represents National Union. William G. Passannante and David A Kochman of Anderson Kill & Olick in New York and Charles L Stern Jr. of Steeg & O'Connor in New Orleans represented United Policyholders as *amicus curiae*.

(**District Court opinion available.** Document #03-041026-102Z.) ■

Panel Finds Conflict Of Interest; Insured Entitled To Independent Counsel

ELGIN, Ill. — A conflict of interest exists between a contractor and its insurer that entitles the policyholder to be defended against underlying allegations by an attorney of the builder's choosing, the Second District Appellate Court of Illinois found Feb. 6, reversing a trial court (American Family Mutual Insurance Co. v. W.H. McNaughton Builders Inc., No. 2-05-0063, Ill. App., 2nd Dist.; 2006 Ill. App. LEXIS 63).

(**Opinion in Section B.** Document #03-060221-102Z.)

In 2004, Fred and Marianne Begy sued W.H. McNaughton Builders Inc., alleging breach of implied warranty and breach of implied warranty of habitability as to installation of an exterior insulation and finish system (EIFS) on their home, which was built in 1991 and 1992.

McNaughton was insured under an American Family Mutual Insurance Co. CGL policy issued in 1994. Pursuant to the policy, covered property damage was damage that occurred during the policy period and of which the insured was unaware before the policy's effective date.

Reservation Of Rights

American Family defended McNaughton under a reservation of rights, explaining that the policy did not cover property damage occurring before the policy's inception in 1994, the policy did not cover property damage that resulted from mold and occurred after Dec. 31, 2002, and did not cover property damage that McNaughton knew about before the policy's inception in 1994.

McNaughton said that because of a conflict of interest, it was entitled to hire independent counsel to represent it in the Begy action. According to McNaughton, although both McNaughton and American Family had a mutual interest in McNaughton's being found not liable in the Begy suit, American Family's interests would be equally protected if McNaughton were found liable for damages not covered by the policy.

Ultimately, American Family filed this action against McNaughton, seeking a declaration that there was no conflict and that it should be permitted to control McNaughton's defense in the Begy action.

On cross-motions for judgment on the pleadings, the Du Page County Circuit Court found no clear conflict of interest that would require or permit the court to allow the appointment of independent counsel, only a potential conflict depending on discovery in the underlying case. McNaughton appealed.

Existence Of Conflict

The appellate court explained that the conflict situation is an exception to the rule that the insurer being charged with the duty of defending its insured should be permitted to control the policyholder's defense. The existence of a conflict is determined by comparing the underlying complaint's allegations to

the policy language. If it appears that factual issues will be resolved in the underlying suit that would allow insurer-retained counsel to lay the groundwork for a later denial of coverage, then there is a conflict between the interests of the insurer and those of the insured, the court said.

McNaughton argued that a conflict exists because American Family's interests will be served if McNaughton is found liable for damage occurring before the policy's inception.

"Both American Family and McNaughton share an interest in McNaughton's being found not liable for any damage to the Begys' home. But American Family's interests would be equally served if McNaughton were found liable for damage that occurred prior to the Policy's inception in 1994. Thus, although the insurer and the insured share an interest, their interests also diverge. Therefore, there is a conflict," the appeals court found.

The court also disagreed with the trial court's finding that only a potential conflict existed depending on what is shown by discovery in the Begy Suit. "A conflict already exists here because American Family's interests would be served by fleshing out in discovery facts showing that the damage to the Begys' home occurred prior to the inception of the Policy, while McNaughton's interests would be served by fleshing out facts showing that the damage occurred after the inception of the Policy. In this regard, an attorney representing American Family's interests would be the enemy of McNaughton," the court said. "Thus, McNaughton should not be forced to use American Family's attorneys to defend against the Begys' claims." ■

Withdrawal Of Defense Justified; Insurer May Rely On Consent To Settle Clause

RALEIGH, N.C. — An insurer's withdrawal of its defense following a favorable decision on the pollution exclusion was justified and was not a breach of contract; thus, it may rely on its defense that the insured settled with claimants without its consent, a North Carolina judge held Feb. 7 (Auto-Owners Insurance Co. v. Whitewood Properties Inc., et al., No. 5:01-CV-819, E.D. N.C.).

(**Opinion in Section F.** Document #03-060221-106Z.)

Contaminated Well Water

In 2003, the U.S. District Court for the Eastern District of North Carolina ruled that Auto-Owners Insurance Co. had no duty to defend Whitewood Properties Inc., a developer of a subdivision sued by homeowners alleging well water was contaminated. The court held that the pollution exclusion barred coverage.

The insurer then withdrew its defense of Whitewood, although Whitewood and the claimants appealed the pollution exclusion ruling. Whitewood notified Auto Owners of its intent to settle with claimants and requested that the insurer resume its defense. Citing the District Court's decision, the insurer refused. Despite the insurer's warning that the policy barred the insured from entering into settlements without the insurer's consent, Whitewood settled with the claimants.

In 2004, the Fourth Circuit U.S. Court of Appeals vacated and remanded the decision, finding that a discharge into the environment is required (See 8/3/04, Page 3). In an unpublished opinion, the appeals court instructed the District Court to reconsider its decision on the pollution exclusion and to consider other exclusions as well.

The claimants then filed a motion for summary judgment in March 2005, and all the parties briefed the duty to defend issue. In August, Auto Owners reached a settlement with Whitewood. Supplemental briefing with respect to summary judgment was filed through December. Auto Owners contended that its settlement with its insured, Whitewood, rendered the duty to defend issue moot. The claimants asserted that the insurer's unjustified withdrawal of its defense forced Whitewood to settle with them and, therefore, that the insurer waived its right to rely on the consent to settlement clause to refute coverage.

Withdrawal Not Unjustified

Senior Judge W. Earl Britt said the settlement between Auto Owners and Whitewood does not moot the duty to defend issue. Continuing with the duty to defend, he said Auto Owners' withdrawal of its defense after obtaining a declaratory judgment on coverage cannot be considered unjustified or a breach of contract that relieved Whitewood from complying with conditions of the policy. Whitewood or the claimants could have sought a stay of the judgment pending the outcome of the appeal if they wanted a continued defense, he said.

"As previously recognized, the insured, Whitewood, entered a settlement with the Potter litigants without Auto-Owners' consent. Having entered an unauthorized settlement agreement, the Potter litigants, as Whitewood's assignees, are precluded from relying on that agreement as a basis for indemnification by Auto-Owners," he said.

The claimants filed a notice of appeal to the Circuit Court Feb. 9.

The claimants are represented by Raleigh, N.C., attorneys Jonathan D. Sasser, Curtis J. Shipley and Thomas H. Segars of Ellis & Winters. Kurt J. Olson and Tyler L. Randolph of Maupin Taylor & Ellis in Raleigh represent Whitewood. John A. Yeager of Willingham & Coté in East Lansing, Mich., and Walter E. Brock Jr. of Young, Moore & Henderson in Raleigh are counsel for Auto-Owners.

(Additional documents available: **Fourth Circuit opinion.** Document #03-040803-101Z. **Trial court's 2003 decision.** Document #03-040803-030Z. **Complaint.** Document #03-040803-029C.) ■

Untimely Notice Of Potential Lawsuit Bars Environmental Coverage

NEW YORK — Coverage for costs associated with a Long Island landfill site are not covered, a New York appellate panel affirmed Dec. 8, where notice was due not when the insured was sued a few weeks before providing notice, but six months earlier when the insured received a letter threatening a lawsuit (Long Island Lighting Co., et al. v. Allianz Underwriters Insurance Co., et al., No. 5216, N.Y. Sup., App. Div. 1st Dept.; 2005 N.Y. App. Div. LEXIS 13838).

(**Opinion in Section E.** Document #03-060221-105Z.)

A majority of the First Department New York Supreme Court Appellate Division affirmed a decision by the New York County Supreme Court that coverage is barred for Long Island Lighting Co.'s environmental liability with respect to the Syosset Landfill site due to late notice.

Long Island Lighting and its successor, Keyspan Corp., used the landfill from 1954 to 1975, when it was closed by the Nassau County Department of Health. In 1989, the U.S. Environmental Protection Agency (EPA) advised Long Island Lighting that the release of hazardous materials had been documented at the site and requested information about the nature of the materials disposed of at the site. In 1990, the EPA advised Long Island Lighting in a letter of the proposed Superfund plan for the site.

Cleanup

Three years later in September 1993, the Town of Oyster Bay, where the site is located, sent a letter to Long Island Lighting, asserting that it, along with 37 other companies, was liable under state and federal law for

the cleanup costs. In February 1994, the town filed a lawsuit against only 15 of those companies, including Long Island Lighting. On March 25, 1994, Long Island Lighting informed various insurers of the lawsuit.

The lower court concluded that Long Island Lighting knew that the town would hold it responsible for the cleanup from the September 1993 letter. However, Long Island Lighting asserts that the letter was received after three years of no communication with the EPA or the town about the site and that the letter appeared to be a form letter sent to 37 other Long Island companies, most of which were not named as defendants in the town's subsequent lawsuit.

Long Island Lighting failed to give notice upon the happening of an "occurrence" reasonably likely to involve the policies of defendant insurers, the appellate majority held.

"We reject plaintiff's argument that there was a reasonable possibility that the subject policies, both excess, would not be reached by the Syosset claim, where plaintiff offers no evidence that the timing of its notice was the result of a deliberate determination to that effect, and not, as the record suggests, the belief that it was not responsible for the Syosset cleanup costs. Nor does it avail plaintiff to argue that defendants were not prejudiced by the late notice," the majority said.

Dissent

Dissenting, Justice James M. Catterson, joined by Justice Betty Weinberg Ellerin, observed that Long Island Lighting avers that a finder of fact could conclude that it did not appear likely that a claim allocated among the decades of triggered policies would reach any of the excess policies at issue.

"Additionally, whether LILCO's belief about the implication of its excess policies was, in fact, based on any such assessment is another question for the finder of fact, and should not have been resolved by the court on summary judgment," she said.

Century Indemnity Co. and General Reinsurance Corp. moved for summary judgment on notice issue. Other insurers were dismissed based on the lower court's determination that their excess insurance would not be reached.

High Court Review

As of Jan. 19, plaintiffs appealed the Appellate Division's decision to the Court of Appeals.

David L. Elkind of Dickstein Shapiro Morin & Oshinsky in New York represents Keyspan. Lawrence A. Nathanson of Siegal, Napierkowski & Park in Cherry Hill, N.J., is counsel for Century Indemnity. Michael J. Balch of Skadden, Arps, Slate, Meagher & Flom in New York is the attorney for General Reinsurance. ■

California Judge Allows Contribution Claim Between Primaries, Not Against Excess

SAN FRANCISCO — A portion of an equitable contribution claim is viable as pertaining to contribution between primary insurers that insured a builder who tendered a construction defect lawsuit, a California federal judge held Jan. 19 (Travelers Casualty & Surety Co. v. Insurance Company of the State of Pennsylvania, et al., No. C 04-03975, N.D. Calif.).

(**Opinion in Section G.** Document #03-060221-107Z.)

U.S. Judge William Alsup of the Northern District of California ruled that Travelers Casualty & Surety Co. may pursue a claim for contribution of sums paid under primary policies against other primary level policies issued by Insurance Company of the State of Pennsylvania (ICSOP).

Travelers paid $12 million, and National Union Fire Insurance Company of Pittsburgh, Pa., paid $4.25 million toward settling an underlying suit against their insured, Perini Building Co. Travelers and ICSOP deposited funds into an account held by Legal Cost Consultants to pay Perini's defense fees. Travelers filed this suit against ICSOP and National Union, contending that it paid a disproportionate share.

Excess Insurance

Travelers does not have a right to contribution against National Union, which only provided excess insurance to the builder, the judge held. As a general rule in California, contribution rights don't exist between

(continued on page 13)

MEALEY'S™ Fundamentals of Reinsurance Litigation & Arbitration Conference

March 23-24, 2006, The Ritz-Carlton, Boston

Conference Chaired by
Lewis E. Hassett. Esq., Morris, Manning & Martin, L.L.P., Atlanta
Richard H. Porter, Esq., Steptoe & Johnson LLP, Washington, DC

Thursday, March 23, 2006

8:00 **Registration & Continental Breakfast**

8:45 **Welcome & Introductory Remarks**
Lewis E. Hassett, Esq., Morris, Manning & Martin, L.L.P., Atlanta
Richard H. Porter, Esq., Steptoe & Johnson LLP, Washington, DC

9:00 **From the Beginning – An Introduction to Reinsurance**
- What is reinsurance?
- Overview of the types of reinsurance
- Treaty vs. facultative reinsurance; proportional vs. excess of loss reinsurance; traditional vs. finite reinsurance
- What is a retrocessionaire?
- The roles of Brokers/MGAs and MGUs

Barry Leigh Weissman, Esq., Sonnenschein Nath & Rosenthal LLP, Los Angeles

10:00 **Morning Break**

10:15 **Key Principles and Concepts**
- Reinsurance as an honorable engagement
- The duty of utmost good faith
- Follow the fortunes
- Recision
- Other fundamental principles

Antonia B. Ianniello, Esq., Steptoe & Johnson LLP, Washington, DC
Mitchell S. King, Esq., Prince Lobel Glovsky & Tye LLP, Boston

11:15 **Issues Involving Reinsurance Intermediaries**
- Functions and duties
- Compensation issues
- Ability to pursue discovery against
- Legal issues and trends

Peter L. Craft, Senior Vice President, D.W. Van Dyke & Company of Connecticut, Inc., Westport, CT
Daniel J. Eldredge, Jr., Vice President and Associate General Counsel, Benfield Holdings Inc., Minneapolis
Celeste M. King, Walker Wilcox Matousek LLP, Chicago

12:15 **Networking Luncheon**

1:15 **Dealing with the Major Recurring Issues**
- Allocating multiple year losses
- Application of aggregation principles
- Perspectives on follow the fortunes and follow the settlements
- Honorable engagements

Charles M. Foss, Esq., General Counsel, Reinsurance Litigation Division, St. Paul Travelers Insurance Company, Hartford, CT
John D. Cole, Esq., Wiley Rein & Fielding LLP, Washington, DC

2:15 **Reinsurance Disputes – The Corporate Perspective**
- How they arise
- How they may be avoided
- Preference for resolving disputes

Moderator: Mary A. Lopatto, Esq., Chadbourne & Parke LLP, Washington, DC
Carol J. LaPunzina, Senior Vice President, General Counsel & Corporate Secretary, Berkeley Insurance Company, Greenwich, CT
Robert W. Tomilson, Esq., Senior Counsel, CIGNA Corporation, Philadelphia
Elizabeth A. Mullins, Esq., Senior Vice President & Reinsurance Counsel, Swiss Re Life & Health America, Armonk, NY

3:15 **Afternoon Break**

3:30 **Procedural Issues in Reinsurance Disputes**
- Litigation vs. arbitration
- Summary adjudication
- Consolidation
- Compelling arbitration
- The Federal Arbitration Act

William C. O'Neill, Esq., Chadbourne & Parke, LLP, Washington, DC
Keith A. Dotseth, Esq., Larson King, LLP, St. Paul, MN

4:30 **Key Phases of the Arbitration Process**
- Selecting the panel
- Ex Parte Communications
- Confidentiality
- Discovery
- The hearing
- The award

Jessica F. Pardi, Esq., Morris, Manning & Martin, L.L.P., Atlanta
John L. Jacobus, Esq., Steptoe & Johnson LLP, Washington, DC

5:30 **Networking Reception**

Friday, March 24, 2006

8:30 **Continental Breakfast**

9:00 **Reinsurance Regulation**
- How reinsurers are regulated
- Role of the NAIC
- Rating Agencies

Tracey W. Laws, Esq., Senior Vice President & General Counsel, Reinsurance Association of America, Washington, DC

9:30 **Arbitrator's Roundtable**
- Do's and don'ts for counsel and parties
- The role of experts
- Evidence
- The deliberation process

Robert M. Hall, Esq., RMH Consulting, Rockport, ME
Kevin J. Tierney, Esq., Arbitrator/Mediator, Law Office of Kevin Tierney, Falmouth, ME
Lawrence O. Monin, Certified Arbitrator, Moraga, CA

10:30 **Morning Break**

10:45 **Practitioners and Industry Roundtable**
Three prominent members of the reinsurance industry discuss ways to improve the arbitration process and much more

Moderator: Lewis E. Hassett, Esq., Morris, Manning & Martin, L.L.P., Atlanta
Kevin Helewa, Esq., Assistant Secretary, Associate General Counsel & Vice President, Law, Everst Reinsurance Company, Liberty Corner, NJ
Gary Ketels, Esq., Senior Vice President & General Counsel, Clarendon Insurance Group, New York
John B. Rosenquest, III, Esq., Edwards Angell Palmer & Dodge LLP, Hartford, CT

11:45 **Courtroom Activity: An Examination of Recent Decisions Affecting Reinsurance and the Arbitration Process**
- Review of recent judicial decisions
- Impact on the industry

Brian F. Boardingham, Esq., Mound Cotton Wollan & Greengrass, New York
Bruce M. Engel, Esq., Tressler, Soderstrom, Maloney & Priess, Chicago

12:30 **Adjourn**

Registration Information

Registration Fee
The registration fee includes continental breakfast each day, one luncheon, attendance at all conference sessions, a copy of the conference handbook on CD, networking reception, and coffee breaks. The registration fee is $1145 for the first attendee.

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insurers at different risk levels. Thus, Travelers can't pursue contribution for payments under its primary policies against National Union's excess policies.

Travelers also issued an excess policy to the builder. However, any contribution under National Union's excess policies first requires exhaustion of all six of Travelers' primary policies and all four of ICSOP's primary policies, the judge said.

"Given that only $12 million is at stake, there is no possibility that the primary policies would be exhausted such that National Union would be required to contribute on the basis of its excess policies," he concluded.

Travelers' Obligation Questioned

So the only remaining claim is for contribution for sums paid under Travelers primary policies against ICSOP's primary policies. However, there is a question of fact about whether Travelers bore an obligation to indemnify Perini for the leak damage at issue in the underlying suit, Judge Alsup said.

Robert V. Closson and Sandra P. Llaneta of Summers & Shives in San Diego represent Travelers. Patrick Fredette of McCormick Barstow Sheppard Wayte & Carruth in Fresno, Calif., is counsel for ICSOP and National Union.

(Additional document available. **Complaint.** Document #03-041005-022C.) ■

Ohio State Court To Determine Dryvit EIFS Claims Coverage

CINCINNATI — An Ohio state court will determine whether coverage is owed under certain excess liability policies for damages resulting from Dryvit Systems Inc.'s defective synthetic stucco, according to a federal judge's Feb. 9 dismissal of a parallel action (Chubb Custom Insurance Co. v. RPM Inc., et al., No. 05-1903, N.D. Ohio).

(**Opinion available.** Document #03-060221-022Z. **State court complaint available.** Document #03-060221-023C.)

Although Chubb Custom Insurance Co. filed its action in the U.S. District Court for the Northern District of Ohio first, Judge Dan Aaron Polster said the five factors set forth in Brillhart v. Excess Insurance Company of America (316 U.S. 491 [1942]) weigh against exercising jurisdiction over the federal action.

Water Intrusion

In the state court action, Dryvit's parent, RPM Inc., seeks a declaration that Chubb and Agricultural Insurance Co., now known as Great American Assurance Co., are obligated to provide a defense and indemnity in connection with suits alleging property damage and in some cases bodily injury as a result of water intrusion from the installation of exterior insulation and finishing systems (EIFS) manufactured by Dryvit or Dryvit Systems Canada Ltd. RPM's action was filed in the Cuyahoga County Court of Common Pleas.

Chubb and Agricultural issued excess policies to RPM in 1995 and 1996. In Chubb's federal action, Chubb contends that Dryvit and Dryvit Canada are not named insureds under the policies. RPM claims that Dryvit is an additional insured under both insurers' policies.

Separate Excess Layers

Granting RPM and Dryvit's motion to dismiss, Judge Polster found that a judgment by the federal court declaring whether Chubb has a duty to defend or indemnify in this action would serve no purpose and would only be advisory until the state court determines the scope of coverage under Agricultural's policies, which incept below Chubb's attachment point.

Also, the use of the federal action would increase friction between federal and state courts and the state court action is a better remedy given that it includes all the issue of the federal action and more.

RPM acquired Dryvit through a merger in 1995. RPM's state court complaint also includes a claim against and Marsh USA Inc., which brokered the policies, seeking to hold it liable to the extent the insurers prevail.

Barry Fleishman, Divonne Smoyer and Robert Friedman of Dickstein Shapiro Morin & Oshinsky in Washington, D.C., and Michael E. Brittain, Shelly

K. Hillyer and K. James Sullivan of Calfee, Halter & Griswold in Cleveland represent RPM and Dryvit. Joseph A. Ziemianski of Cozen O'Connor in Houston and Daniel F. Gourash, Charles W. Zepp and Robert D. Anderle of Porter, Wright, Morris & Arthur in Cleveland represent Chubb. ■

Home Liquidator's Suit To Recover Defense Costs Dismissed

CONCORD, N.H. — A New Hampshire judge on Feb. 13 dismissed a suit brought by The Home Insurance Co.'s liquidator against an insured to recover costs spent in defense of treated wood litigation (Roger A. Sevigny, Insurance Commissioner, as Liquidator of The Home Insurance Co. v. OM Group Inc. and OMG Americas Inc., No. 05-cv-257, D. N.H.).

(**Opinion available.** Document #12-060216-008Z.)

U.S. Judge Paul Barbadoro of the District of New Hampshire found that OM Group Inc. and OMG Americas Inc.'s contacts with New Hampshire are insufficient to authorize general jurisdiction over the OM defendants, which are domiciled in Ohio.

"Although the Commissioner admittedly has a strong interest in marshaling Home's assets to distribute to its creditors, defendants' contacts with New Hampshire are less continuous and systematic than those found to be insufficient for general jurisdiction in other cases," he said.

Litigation Costs

Roger Sevigny, the New Hampshire insurance commissioner, sued OM to recover close to $1.5 million in defense costs paid to the companies under a reservation of rights in litigation alleging that OMG's wood preservative, known as M-GARD, was defective and caused utility poles to rot prematurely.

Home obtained a declaratory judgment in its favor in an Ohio court with respect to whether it had a duty to defend or indemnify in connection with the treated wood litigation.

By the time the declaratory judgment was final, Home had been declared insolvent by the Merrimack County Superior Court in 2003. The commissioner filed this action in 2005. OM removed the action to the federal court based on diversity jurisdiction and then moved to dismiss based on lack of personal jurisdiction.

Although the New Hampshire Supreme Court has not yet decided whether the Insurers Rehabilitation and Liquidation Act provides the court personal jurisdiction over nonresident corporations, Judge Barbadoro said the state's corporate long-arm statute authorizes jurisdiction over unregistered foreign corporations.

But he found that OM lacks enough contacts with the state to warrant general jurisdiction, noting that the defendants have employed only three sales agents to sell their products in New England, garnering little revenue from sales to New Hampshire customers. Also, the defendants denied having any offices, assets, real property or a registered agent for service of process or banking in New Hampshire or having ever paid taxes in New Hampshire.

J. Christopher Marshall of the New Hampshire Attorney General's Office in Concord and Russell G. Bogin of The Home in New York are counsel to the commissioner. James P. Bassett of Orr & Reno in Concord and Keith A. Vanderburg of Wegman, Hessler & Vanderburg in Cleveland represent the OM defendants. ■

New York Judge Orders Nationwide To Pay $4.3 Million

NEW YORK — A New York state justice on Jan. 25 ordered Nationwide Mutual Insurance Co. to pay $4.3 million to a creditor of an insolvent casualty reinsurance pool, plus future sums that may become due (B.D. Cooke & Partners Ltd. v. Nationwide Mutual Insurance Co., Nos. 5114, 5115, N.Y. Sup., New York Co.).

(**Order available.** Document #12-060216-103Z.)

Reinsurance Pool

Beginning in 1962, Citizens Casualty Company of New York and Nationwide Mutual Insurance Co. participated in a casualty reinsurance pool. Nationwide assumed 10 percent of the reinsurance liabilities and premiums arising from Citizens' fronting agreements with cedents. Citizens assumed 25 percent of the risk and premiums.

B.D. Cooke & Partners Ltd. was a major cedent to the pool, and after Citizens was ordered into liquidation in 1971, Cooke became the estate's largest creditor. Agency Managers became insolvent as well, and ROM Reinsurance Management Co. was formed to take over the management functions.

Citizens remained liable for losses that occurred before it was ordered into liquidation. Its liquidator allowed cedents to file proofs of claims, even when no actual loss could be reported. As long as the cedent filed a proof of claim by Feb. 14, 1972, any actual loss could be reported to the liquidator when the cedent became aware of it, as long as the actual loss occurred before Feb. 14, 1972.

The majority of the risks reinsured by Citizens related to environmental dangers or asbestos exposure, and cedents continued to report actual losses as late as 1996. By 1996, the estate had paid more than 2,000 claims, but the liquidator predicted that cedents would continue to file claims for many years and as such, the final calculation of Citizens reinsurance liabilities would be delayed.

Liquidation Expedited

In 1996, the New York County Supreme Court approved a plan to expedite the closing of Citizens' liquidation. Under the plan, Citizens' liability to Cooke was fixed according to the losses paid as of June 30, 1994. Cooke agreed to withdraw $30.72 million in

outstanding and incurred but not reported claims, and the liquidator agreed to assign Cooke all of the reinsurance recoverables owed to Citizens by the pool members.

The liquidator also proposed to assign Cooke all reinsurance sums due the liquidator as of June 30, 1994, and all reinsurance agreements in favor of Citizens or the liquidator effective from July 1, 1994.

Citizens' liquidation was closed in March 1998 after the liquidator distributed the remaining assets.

Cooke Sues

After the liquidation closed in March 1998, Cooke sued Nationwide in the Supreme Court for $2,020,858. Cooke also sought a declaratory judgment that Nationwide is obligated to reimburse it for all future amounts that become due.

Justice Richard B. Lowe III granted Cooke partial summary judgment, dismissing all of Nationwide's defenses except for one, which was based on offset. The court later dismissed this defense as well, finding that Cooke's entitlement to reinsurance recoverables is not limited by the closing of the estate.

(**Trial court opinion available.** Document #12-050407-006Z.)

After the First Department Supreme Court Appellate Division affirmed the offset ruling, Justice Lowe ordered Nationwide to pay the liquidator $2,698,629.97, plus $1,611,688.95 in interest. It further ruled that Nationwide must pay "all amounts that have or shall become due after May 4, 2005 . . . including, without limitation, all such reinsurance amounts as invoiced by ROM Reinsurance Management Co."

Counsel for Cooke is Carey G. Child of Chadbourne & Parke in Washington, D.C. Nationwide is represented by Gerald A. Greenberger of Rubin Fiorella & Friedman in New York. ■

U.S. Subsidiary Reaches Settlement With Insurers Over Asbestos Claims

WASHINGTON, D.C. — In a Feb. 13 filing with the U.S. Securities and Exchange Commission, Hanson PLC, a London-based company, announced that one of its U.S. construction materials subsidiaries settled with insurers over asbestos claims.

The Form 6-K filing did not name the settling subsidiary but said that the unit is responsible for 20 percent of the group's present asbestos costs. Hanson operates through six divisions: Hanson Aggregates North America, Hanson Building Products North America, Hanson Aggregates UK, Hanson Building Products UK, Hanson Australia & Asia Pacific and Hanson Continental Europe.

The settlement, effective Jan. 1, 2006, concerns policies issued before the mid-1980s, which provided coverage for asbestos-related claims. Hanson said the subsidiary will pay the first $35 million of its future asbestos costs over approximately three years; after that, the insurers will pay up to agreed upon and undisclosed limits.

The filing mentions that other U.S. subsidiaries are litigating asbestos coverage. ■

English Court: Insurer On Risk When Disease Manifested Owes Coverage

LONDON — The England and Wales Court of Appeal ruled Feb. 6 that the insurer on the risk not when asbestos fibers were ingested but when asbestos-related disease developed is obligated to indemnify a municipality that already compensated a worker's family (Bolton Metropolitan Borough Council and Municipal Mutual Insurance Ltd, Commercial Union Assurance Company Ltd, Nos. 2005 1277 & 1310 A3, English App.).

(**Opinion available.** Document #12-060216-010Z.)

Gordon Green died in 1991 from mesothelioma attributable to workplace exposure to asbestos in the

1960s and 1970s. One of the times in which Green inhaled asbestos fibers involved electrical work on a construction project for Bolton Metropolitan Borough Council from 1960 to 1963. Green's estate sued Bolton and another of Green's former employers.

Bolton settled with the estate and sought indemnification from its public liability insurers, Municipal Mutual Insurance Ltd., which insured Bolton in the 1980s, and Commercial Union Assurance Co. Ltd., which provided coverage to Bolton in the 1960s.

'Occurred' During Coverage Period

Counsel for Commercial Union asserted that where employer's liability policies provide coverage with respect to injuries caused during the period of insurance, public liability policies differ in that their coverage is for injuries occurring during the period of insurance.

The High Court, Queen's Bench Division, Liverpool Mercantile Court ruled that Municipal Mutual owed coverage because the mesothelioma was a bodily injury that occurred during its coverage period. Commercial Union was not liable because the disease had not occurred during its policy period. It further ruled that no immediate notice of the injury or claim was given to Commercial Union; thus, Municipal Mutual could not rely on its "other insurance" clause to shift responsibility in the absence of other applicable insurance and no right to contribution existed between the insurers.

The Court of Appeal affirmed, noting that the policy provides indemnification for liability and that Bolton's liability could not have been realized when Green inhaled asbestos fibers. The insuring agreement of the policy refers to bodily injury *occurring* during the "currency of the policy" not the *cause* of such injury, the appellate panel observed.

Multiple Trigger Rejected

Counsel for Municipal Mutual cited the U.S. case Keene Corp. v. Insurance Company of North America (667 F.2d 1043 [D.C. Cir. 1981]), which has spawned decisions holding liable insurers on the risk from the time of first exposure to asbestos to diagnosis of disease.

"I am far from saying that what has been called this multiple trigger or, sometimes, triple trigger theory (exposure, development of disease, and diagnosis) might not be held, on some occasion, to be appropriate for employers' liability policies in general, depending on the precise words used. But, as far as public liability policies are concerned with the specific wording used in the present cases, I see no need for the English courts to adopt the multiple trigger theory. It has been adopted in the United States avowedly for policy reasons in relation to the vastly greater numbers of asbestos-disease sufferers in that country. I see no reason to adopt it in this particular case where the same policy considerations are not present," Lord Justice Longmore wrote for the court. ■

Declaration Sought On Pollution Coverage For Stadium Site Contamination

NEW YORK — An insurer of the St. Louis Cardinals baseball team is challenging its obligation to provide environmental coverage in connection with contamination discovered at the site of the team's new stadium (Greenwich Insurance Co. v. SLC Holdings LLC, as successor in interest to Gateway Group Inc., St. Louis Cardinals LLC, f/k/a St. Louis Cardinals LP, No. 06-745, S.D. N.Y.).

(**Complaint available.** Document #03-060221-021C.)

In a complaint filed Jan. 31 in the U.S. District Court for the Southern District of New York, Greenwich Insurance Co. seeks to rescind the policy or obtain declaratory relief based on alleged misrepresentations in the policy application and breaches of the notice, known conditions and voluntary payments provisions.

Greenwich contends that SLC Holdings LLC, as successor in interest to Gateway Group Inc., and St. Louis Cardinals LLC misrepresented that no prior environmental assessments had been conducted at the site when they knew that audits and studies has been completed before obtaining the policy and that their plans to destroy the old stadium and rebuild on the site would expose the environmental conditions identified in those audits thereby giving rise to a claim under the policy.

Purchase

Gateway purchased the team, the stadium and the surrounding parking and bus lots from Anheuser Busch in 1996. Two Phase I Environmental Audits were conducted in 1995 and 1996 in connection with the sale. The assessments revealed concerns due to historical usage of the property from gasoline stations, foundries, chemical manufacturing, metal plating, electrical substations and oil warehouses. The reports also raised concerns about underground storage tanks and referenced prior environmental identification of contaminated soil and groundwater at the stadium with remediation costs estimated at up to almost $5 million.

Following the purchase, Gateway obtained environmental insurance from Reliance National Indemnity. In 1998, the defendants developed plans for the new stadium that involved destroying the existing stadium and placing the new stadium on the bus lot site, where soil and groundwater contamination had previously been discovered. Defendants obtained a Pollution and Remediation Legal Liability Policy from Greenwich in 2000 shortly before announcing the new stadium plans to the public. The policy period extended to 2005.

No Notice

Greenwich contends that at no time during the application process did the defendants inform Greenwich of conditions at the site that might reasonably be expected to give rise to a claim under the policy or their plans to construct a new stadium on the bus lot site and demolish the old stadium, which could expose conditions identified in the Phase I reports. Nor did defendants inform Greenwich of further environmental audits undertaken in 2002 and 2003.

Greenwich says it was not informed of the defendants' application and acceptance into the Missouri Brownfield Tax Credit Program; enrollment in the state Voluntary Clean Up Program; agreement with the City of St. Louis Land Clearance for Redevelopment Authority, under which ownership of the property was transferred to the authority and a Special Purpose Entity was designated for funding remediation; or commencement of soil removal at the bus lot site in November 2003.

It was not until January 2004 that Greenwich was notified of a claim for cleanup costs associated with petroleum and heavy metals at the bus lot site and March 2005 that defendants submitted a claim for cleanup costs arising from the presence of lead, mercury and petroleum at the former stadium site. This notice was untimely, the insurer says.

Gateway contends that it has incurred more than $14 million in cleanup costs for the bus lot site but that it received Brownfield tax credits, which it converted to $6.6 million cash.

The complaint was filed by Charles Platto and Nolan Burkhouse of The Platto Law Firm in New York. ■

Odyssey Sued For $500,000 In Asbestos Claims

BOSTON — Two insurers are seeking more than $500,000 in indemnity from Odyssey America Reinsurance Inc. for personal injury asbestos claims brought against their policyholder (Stonewall Insurance Co. and Seaton Insurance Co. v. Odyssey America Reinsurance Corp., No. 05 CA 12529 RCS, D. Mass.).

(**Complaint available.** Document #12-060216-005C.)

The Dec. 15 complaint, filed in the U.S. District Court for the District of Massachusetts, lists two counts of breach of contract and prays for declaratory relief.

According to the plaintiffs, Odyssey America Reinsurance Inc. (formerly known as Skandia America Reinsurance Corp.) reinsured policies issued to Studebaker-Worthington Inc. by Stonewall Insurance Co. and Seaton Insurance Co. (formerly known as Unigard Mutual Insurance Co.).

Reinsurance Billings

To date, Seaton has paid more than $6 million and Stonewall $5 million for asbestos bodily injury claims brought against Studebaker, the insurers say.

Seaton allegedly billed Odyssey $386,009, and Stonewall says it billed the reinsurer $116,134. Both insurers claim that Odyssey has refused to pay.

The two insurers seek damages for breach of contract in the amount of the reinsurance billings, plus interest, costs and attorney fees. They have also asked the court for a declaratory judgment that Odyssey is obligated to indemnify them under the facultative certificates.

Dismissal Requested

In a Feb. 6 motion to dismiss, Odyssey asserts that it has been incorrectly sued as the successor to Skandia America. Odyssey disclaims that it is the entity that issued the reinsurance contracts and asserts that the contracts were actually issued by Skandia America and Skandia Insurance Co.

(**Motion available.** Document #12-060216-006B.)

It denies that it succeeded to any obligations of Skandia and notes that Skandia's correct successor is Clearwater Insurance Co., which is a separate and distinct entity from Odyssey. Both Odyssey and Clearwater are subsidiaries of Odyssey Re Holdings Corp., it says. In the mid-1990s, Skandia America changed its name to Odyssey Reinsurance Corp. and then to Clearwater in 20003, Odyssey says.

But naming Clearwater as the proper defendant would be immaterial, it says, noting that on the day it filed its motion to dismiss, Clearwater initiated a declaratory judgment action of its own in Connecticut against Stonewall and Seaton.

(**Complaint available.** Document #12-060216-007C.)

Stonewall and Seaton are represented by Kevin J. O'Connor and Peter C. Netburn of Hermes Netburn O'Connor & Spearing in Boston. Laura B. Angelini of Hinckley, Allen and Snyder in Boston represents Odyssey.

David A. Slossberg of Hurwitz, Sagarin, Slossberg & Knuff in Milford, Conn., represents Clearwater. ■

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In the space of a few months in early 2005, Medtronic announced it had found problems with batteries that power one of its implantable cardiodefibrillator (ICD) heart device and Guidant confirmed that it knew of defects in some models of its ICDs and its cardiac resynchronization therapy defibrillators, another heart device. With a few deaths attributed to failed devices and many more replacement surgeries taking place, plaintiff attorneys filed scores of class action and individual lawsuits seeking compensation for injuries and medical monitoring. Petitions have been filed to centralize federal lawsuits for both Medtronic and Guidant devices. This special report traces company and regulatory action involving the devices, as well as cases that have been filed in this emerging litigation. Published November 2005 - $295.

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- **Toxic Tort Update: Texas**
  March 9-10. Dallas. Sessions will cover the state of litigation in Texas, from jurisdictional issues to effective trial tactics, mass-screening litigation and legislation updates, recent changes in Texas law and how they affect cases, emerging issues in welding rod and benzene litigation and the role of insurance under Texas law and how it applies to bad faith, asbestos, silica, mold, construction defect and punitive damages cases. Co-chairs are Sharla J. Frost of Powers & Frost in Houston and Richard I. Nemeroff of The Nemeroff Law Firm in New York.

- **Fundamentals Of Reinsurance Litigation & Arbitration**
  March 23-24. Boston. Sessions will explore the difference between traditional and finite reinsurance, the procedural issues in reinsurance disputes, the ins and outs of allocation and aggregation issues and major recurring reinsurance issues such as follow the fortunes and the Federal Arbitration Act. Co-chairs are Richard H. Porter of Steptoe & Johnson in Washington, D.C., and Lewis E. Hassett of Morris, Manning & Martin in Atlanta.

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Appeal No. 2005AP1092 Cir. Ct. No. 2002CV13

WISCONSIN COURT OF APPEALS
DISTRICT IV

GLENDENNING'S LIMESTONE & READY-MIX COMPANY, INC.,

PLAINTIFF,

V.

MICHAEL A. REIMER,

DEFENDANT,

HENK KENKHUIS AND LINDA KENKHUIS,

DEFENDANTS-THIRD-PARTY
PLAINTIFFS-APPELLANTS,

WEST BEND MUTUAL INSURANCE COMPANY,

INTERVENOR-THIRD-PARTY
DEFENDANT-RESPONDENT.

FILED

Feb. 9, 2006

Cornelia G. Clark
Clerk of Supreme Court

CERTIFICATION BY WISCONSIN COURT OF APPEALS

Before Vergeront, Deininger and Higginbotham, JJ.

Pursuant to WIS. STAT. RULE 809.61 (2003-04)[1] we certify this appeal to the Wisconsin Supreme Court for its review and determination. The facts of the case provide the court with an opportunity to clarify or refine and further apply its decision in ***American Family Mut. Ins. Co. v. American Girl, Inc.***, 2004 WI 2, 268 Wis. 2d 16, 673 N.W.2d 65, holding that there was an "occurrence," as that term is used in a commercial general liability (CGL) policy, when a subcontractor provided faulty consulting services that were a cause of structural damage. The issue in the present case is whether there was an occurrence when a subcontractor allegedly failed to perform dairy facility modifications in the manner contracted for by the facility owner, causing the structure to be less suitable for its normal use.

[1] All references to the Wisconsin Statutes are to the 2003-04 version unless otherwise noted.

The amended complaint of Henk and Linda Kenkhuis alleged that Michael Reimer entered into a contract to provide construction services to a dairy facility in which they had a leasehold interest; that the majority of the work on the facility was performed by subcontractors selected, retained, and paid by Reimer; and that the concrete subcontractor was negligent by pouring and finishing concrete for approximately 1450 cow stalls, such that the stalls have an inadequate slope, and by failing to pour the concrete over the top of a preexisting eight inch cement curb.

The complaint further alleged that the negligence of subcontractors hired by Reimer in performing their work caused the following accidental damage to the Kenkhuises' property:

> (a) The cow stalls are damaged in that they were not constructed per their specifications and must be repaired; (b) As a result of the inadequate slope, urine and manure gathers in puddles in the cow stalls and flows backwards rather than flowing to the designated drainage area; (c) As a result of the improper installation of rubber mats by Reimer and/or his subcontractors, the scraper which cleans manure has damaged the rubber mats; (d) The stall loops were irregularly and inconsistently installed by subcontractors throughout the building; and (d) The neck bars for the cows are loose and irregular and not attached to either end of the barn.

Finally, as another consequence of the alleged negligence, the Kenkhuises alleged that their cows' flanks and udders are dirty, creating potential for disease transmission and requiring the Kenkhuises to engage extra labor, at extra expense, to clean the udders prior to milking.

The complaint alleged that West Bend Mutual Insurance Company had a liability policy insuring Reimer. West Bend sought an order that its policy does not provide coverage on these facts. The circuit court granted West Bend's motion for summary judgment. On appeal, West Bend agrees with the appellants that the circuit court's ground for granting summary judgment was erroneous. West Bend relies on other arguments to sustain the judgment in its favor.

We regard the dispositive issue to be whether there was an "occurrence," as defined in West Bend's policy. Resolving the issue requires an interpretation and application of ***American Girl***, in which the court interpreted a definition of "occurrence" that is identical to the one now before us. *See* ***American Girl***, 268 Wis. 2d 16, ¶5. The present policy provides that coverage extends to bodily injury and property damage only if the injury or damage is caused by an "occurrence." "Occurrence" is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

In ***American Girl***, a soil engineering subcontractor gave faulty site-preparation advice to a general contractor in connection with the construction of a warehouse and, as a result, there was excessive settlement of the soil after the building was completed, causing the building's foundation to sink. ***Id.***, ¶3. This caused the rest of the structure to buckle and crack, and ultimately the building was declared unsafe and had to be torn down. ***Id.*** American Family had issued a

CGL policy to the general contractor, and the issue in litigation was whether the policy applied to the claim against the contractor by the building owner. ***Id.***, ¶4.

A significant portion of the ***American Girl*** opinion was devoted to the question of whether there was an "occurrence." ***Id.***, ¶¶37-49. Much of the discussion in the opinion focused on an argument that is not raised in the present case and is not directly related to the present issue, namely, whether the building owner's claim could not be an "occurrence" because it was for breach of contract/breach of warranty, and the CGL policy is not intended to cover contract claims arising out of the insured's defective work or product. ***Id.***, ¶39. The court concluded that classifying a claim as contract or tort does not answer whether there has been an occurrence, and that a breach of contract or breach of warranty claim can be an occurrence. ***Id.***, ¶¶39-47.

The discussion in ***American Girl*** that is more directly related to the present case is that concerning the word "accident." "Accident" is used within the definition of "occurrence" but is not defined by the policy. The pertinent paragraphs are these:

> ¶37. Liability for "property damage" is covered by the CGL policy if it resulted from an "occurrence." "Occurrence" is defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The term "accident" is not defined in the policy. The dictionary definition of "accident" is: "an event or condition occurring by chance or arising from unknown or remote causes." *Webster's Third New International Dictionary of the English Language* 11 (2002). Black's Law Dictionary defines "accident" as follows: "The word 'accident,' in accident policies, means an event which takes place without one's foresight or expectation. A result, though unexpected, is not an accident; the means or cause must be accidental." *Black's Law Dictionary* 15 (7th ed. 1999).

> ¶38. No one seriously contends that the property damage to the 94DC was anything but accidental (it was clearly not intentional), nor does anyone argue that it was anticipated by the parties. The damage to the 94DC occurred as a result of the continuous, substantial, and harmful settlement of the soil underneath the building. Lawson's inadequate site-preparation advice was a cause of this exposure to harm. Neither the cause nor the harm was intended, anticipated, or expected. We conclude that the circumstances of this claim fall within the policy's definition of "occurrence."
>
> ....
>
> ¶48. The court of appeals has previously recognized that the faulty workmanship of a subcontractor can give rise to property damage caused by an "occurrence" within the meaning of a CGL policy. In ***Kalchthaler v. Keller Construction Co***., 224 Wis. 2d 387, 395, 591 N.W.2d 169 (Ct. App. 1999), a general contractor subcontracted out all the work on a construction project; the completed building subsequently leaked, causing over $500,000 in water damage. The court of appeals noted that the CGL defined "occurrence" as "an accident," and further noted that "[a]n accident is an 'event or change occurring without intention or volition through carelessness, unawareness, ignorance, or a combination of causes and producing an unfortunate result.'" ***Id***. at 397 (quoting *Webster's Third New International Dictionary* 11 (1993)). The court of appeals concluded that the leakage was an accident and therefore an occurrence for purposes of the CGL's coverage grant. ***Id***.
>
> ¶49. The same is true here. We conclude that the property damage to the 94DC was the result of an "occurrence" within the meaning of the insuring agreement. This brings us to the policy exclusions. American Family invokes several.

Id., ¶¶37-38, 48-49 (footnotes omitted).

The parties disagree as to how ***American Girl*** applies to the present facts. The Kenkhuises argue that the facts of this case are very similar to ***American Girl***. In their view, their claim is against the general contractor for negligence of a subcontractor that has caused property damage; the language of the relevant policy is identical; and the damage was accidental, in the sense that it

was not intentional or anticipated. Therefore, according to the Kenkhuises, the policy provides an initial grant of coverage.

In contrast, West Bend argues that ***American Girl*** is distinguishable. The main distinction, according to West Bend, is that the Kenkhuises' complaint does not allege accidental *conduct* by the subcontractor, only an accidental *result*. In other words, West Bend points out that the subcontractors in this case intended to do the work in the manner that they did, even though it may have been deficient. West Bend argues that the details and end-product of a construction project are matters that can be, and usually are, planned to occur. They argue that the term "accident" should not include the "overt, blatant, volitional acts" alleged in the Kenkhuises' complaint. West Bend contrasts these facts with ***American Girl*** in which, they argue, the failure of the subcontractor to give proper advice about soil conditions can properly be characterized as a mistake or accident. This argument rests in part on one of the dictionary definitions relied on in ***American Girl***, which stated that a "result, though unexpected, is not an accident; the means or cause must be accidental." ***Id.***, ¶37. Finally, West Bend argues that the Kenkhuises' interpretation of ***American Girl*** would have the practical effect of making *all* substandard work by subcontractors an "occurrence" under the policy.

In short, we see the dispositive issue as this: should ***American Girl*** be read broadly to mean that all faulty work by subcontractors is an occurrence? Or, should it be read more narrowly to say that negligence by subcontractors can be an occurrence under some circumstances? And, if subcontractor negligence is an occurrence under only certain circumstances, what are the analytical tools or definitions that will enable courts, litigants, and parties to proposed insurance contracts to reliably and consistently determine whether particular circumstances qualify as occurrences?

Because the above questions raise statewide concerns of interest to all insurers and holders of CGL policies, and they require interpretation of a recent supreme court opinion and further development or modification of analysis in a supreme court opinion, we believe the supreme court is the better court to decide this appeal.

McNAUGHTON BUILDERS

No. 2--05--0063

filed: 2/6/06

IN THE

APPELLATE COURT OF ILLINOIS

SECOND DISTRICT

AMERICAN FAMILY MUTUAL INSURANCE COMPANY, Plaintiff-Appellee,	)	Appeal from the Circuit Court of Du Page County.
v.	)	
W.H. McNAUGHTON BUILDERS, INC., a/ka/ W.H. McNaughton Builders, LLC, Defendant-Appellant.	)	No. 04--MR--1212
	)	Honorable Bonnie M. Wheaton, Judge, Presiding.

JUSTICE McLAREN delivered the opinion of the court:

In 2004, defendant, W.H. McNaughton Builders, Inc., a/k/a W.H. McNaughton Builders, LLC (McNaughton), was sued by Fred and Marianne Begy (the Begy Suit), whose home McNaughton had built in 1991. McNaughton turned the Begy Suit over to its insurer, plaintiff, American Family Mutual Insurance Company (American Family), which, pursuant to its policy with McNaughton, had a duty to defend the suit. American Family agreed to comply with its duty to defend, but reserved the right to later deny coverage if McNaughton were found liable for damage occurring before the inception of the policy in 1994. In response, McNaughton argued that American Family and McNaughton had a conflict of interest, because American Family's interests would be protected if McNaughton were found liable in the Begy Suit for damage occurring before 1994.

Because American Family's interests would be protected if McNaughton were found liable, McNaughton argued that it should not be forced to defend the Begy Suit with an attorney retained by American Family. Rather, McNaughton argued that it should be permitted to select its own attorney at American Family's expense in accordance with well-settled law. American Family disagreed. It filed a declaratory judgment action in which it argued that there was no conflict and sought a determination that it had the right to select McNaughton's attorney. The trial court found that there was no current conflict, and accordingly it granted declaratory judgment for American Family. McNaughton appeals, and we reverse and remand.

I. BACKGROUND

American Family issued a commercial general liability policy (the Policy) to McNaughton in 1994. As part of the Policy, American Family agreed that, in exchange for McNaughton's payment of annual premiums, American Family would cover expenses for which McNaughton became liable because of "property damage" covered by the Policy. According to the Policy, covered property damage was damage that, among other restrictions, occurred during the Policy period and of which the insured was unaware prior to the Policy's inception. Additionally, in order to be covered by the Policy, the damage had to come within the Policy's definition of "property damage," which, in relevant part, was as follows:

"a. Physical Injury to tangible property, including all resulting loss of use of that

property. All such loss of use shall be deemed to occur at the time of the physical injury that

caused it; or

b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it."

In turn, the Policy defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

American Family added another policy exclusion, effective December 31, 2002. Specifically, as of that time, the Policy excluded from coverage, among other things, "direct or indirect losses resulting from" "property damage *** includ[ing] any claim for diminution of value of real or personal property due to its contamination with 'mold' in any form." The Policy remained current through 2004.

In July of that year, the Begys sued McNaughton. In their two-count complaint, the Begys alleged breach of implied warranty and breach of implied warranty of habitability. Count I alleged that, in building the Begys' home, McNaughton breached an implied warranty requiring it to install in a good and workmanlike manner an exterior insulation and finish system (EIFS).[1] Count II alleged, among other things, that, as a result of McNaughton's failings, the Begys' home suffered mold damage. Although the complaint did not allege any dates, the agreement between the Begys and McNaughton was attached to it, and, according to that agreement, construction of the home was to begin in September 1991 and be "substantial[ly]" completed by June 1992.

McNaughton informed American Family of the Begy Suit, and American Family retained counsel to defend McNaughton. Shortly after doing so, however, American Family advised McNaughton that American Family would be defending the Begy Suit under a complete reservation of rights to later deny coverage. In reserving its rights, American Family pointed out that: (1) the Policy did not cover property damage occurring prior to the Policy's inception in 1994; (2) the Policy did not cover property damage that resulted from mold and occurred after December 31, 2002; and (3) the Policy did not cover property damage that McNaughton knew about before the Policy's inception in 1994.

After receiving notice of American Family's reservation of rights, McNaughton advised American Family that, due to a conflict of interest, McNaughton was entitled to hire independent counsel to represent it in the Begy Suit. According to McNaughton, a conflict existed because, although both McNaughton and American Family had a mutual interest in McNaughton's being found not liable in the Begy Suit, American Family's interests would be equally protected if McNaughton were found liable for damages not covered by the Policy. McNaughton noted that the Policy did not cover

damage that occurred before 1994 or damage that McNaughton knew about before 1994 or damage that was due to mold and that occurred after 2002. McNaughton also noted that the Begys' claims dealt both with mold damage and with breaches of warranties occurring prior to 1994, that is, when the Begys' home was built in 1991 and 1992. Finally, McNaughton noted that issues as to the timing of the alleged damage--issues, that is, that McNaughton said would be resolved in the Begy Suit--could determine whether McNaughton had coverage under its policy with American Family. For these reasons, McNaughton argued, a conflict of interest existed between McNaugton and American Family, and, therefore, it was improper for American Family to control McNaughton's defense in the Begy Suit. McNaughton asked American Family to allow McNaughton to retain independent counsel to defend it against the Begys' allegations.

American Family responded to McNaughton's request by filing a declaratory judgment action against McNaughton. In its complaint, American Family asked the trial court to declare that there was no conflict and that, accordingly, American Family should be permitted to select the attorney to control McNaughton's defense in the Begy Suit.

The parties filed cross-motions for judgment on the pleadings. In support of its motion, American Family argued, inter alia, that there was no conflict because there would be no opportunity in the Begy Suit for counsel retained by American Family to shift facts to lay the basis for American Family to later deny coverage to McNaughton. To this end, American Family pointed out that it had reserved the right to deny coverage on the basis of, among other things, the timing of the damage to the Begys' home. American Family also pointed out that the Begys claimed that McNaughton had failed to properly construct their home and that, as a result, their home had suffered mold damage. This being the case, American Family argued that the Begys' claims did not raise an issue of when the damage occurred. Thus, American Family argued that there was no conflict, and, consequently, it should be permitted to appoint its own attorney to defend McNaughton in the Begy Suit.

In response, McNaughton argued that the Begys' claims did raise an issue of timing, which would be the subject of discovery in the Begy Suit. McNaughton argued that, if American Family were permitted to control the defense of the Begy Suit, then this discovery would be controlled by attorneys retained by American Family--attorneys, that is, with a long-standing financial relationship with American Family. Because, depending on what the discovery revealed as to timing, McNaughton could lose coverage under the Policy, McNaughton argued that there was a conflict. Consequently, McNaughton argued, American Family should not be allowed to use its own attorneys to control McNaughton's defense in the Begy Suit.

The trial court rejected McNaughton's argument. Specifically, at a hearing on the parties' motions, the trial court found that there was no "clear conflict of interest," only a "possible or potential conflict of interest depending on what the discovery shows." The trial court explained:

"[A]t this point in time, it is clearly within the mutual interest of both W.H. McNaughton and American Family to find that *** there was no property damage of the type that is alleged; only if that question is *** answered in the affirmative would it possibly come into *** the issue of when the damage took place ***. But at this point in time, [the court] do[es]n't think that there is a conflict of interest which would require or even permit the court to allow the appointment of independent counsel ***."

Having concluded that there was no present conflict, the trial court granted American Family's motion for judgment on the pleadings. McNaughton appeals.

II. ANALYSIS

We begin with the standard of review. A motion for judgment on the pleadings is properly granted only if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Gillen v. State Farm Mutual Automobile Insurance Co., 215 Ill. 2d 381, 385 (2005). Our review of the trial court's decision on a motion for judgment on the pleadings is de novo. M.A.K. v. Rush-Presbyterian-St.Luke's Medical Center, 198 Ill. 2d 249, 255 (2001).

The sole issue in this appeal is whether a conflict of interest exists between McNaughton and American Family that entitles McNaughton to be defended against the Begys' allegations by an attorney of McNaughton's choosing. Before turning to that issue, however, it is helpful to begin our analysis with a word about an insurer's duty to defend its insured.

An insurer's duty to defend its insured is much broader than its duty to indemnify its insured. General Agents Insurance Co. of America, Inc. v. Midwest Sporting Goods Co., 215 Ill. 2d 146, 154 (2005). If a complaint against an insured contains allegations that are even potentially within policy coverage, the insurer is obligated to defend the insured. See Guillen v. Potomac Insurance Co. of Illinois, 203 Ill. 2d 141, 150 (2003). Stated another way, an insurer may not justifiably refuse to defend its insured unless it is clear from the face of the complaint that the complaint has failed to allege facts potentially within the insured's policy coverage. Dixon Distributing Co. v. Hanover Insurance Co., 161 Ill. 2d 433, 439 (1994). In making this determination, the allegations of the complaint must be liberally construed in favor of coverage. Midwest Sporting Goods Co., 215 Ill. 2d at 155.

Here, the Begys allege in the underlying suit that McNaughton failed to properly apply an EIFS to their home (which McNaughton apparently built during 1991 and 1992) and that, as a result, their home suffered mold damage. Although the Begys' home was apparently built prior to the 1994 inception of the Policy, American Family has not alleged here that it does not have a duty to defend McNaughton. Rather, American Family argues that it should get to control McNaughton's defense. McNaughton, as noted, responds that there is a conflict of interest, and, because there is, McNaughton should be permitted to control its own defense by using its own attorney.

The conflict situation is an exception to the rule that the insurer, being charged with the duty of defending its insured, should be permitted to control the insured's defense. Illinois Masonic Medical Center v. Turegum Insurance Co., 168 Ill. App. 3d 158, 163 (1988). Permitting the insurer to control the insured's defense allows the insurer to protect its financial interests and to minimize unwarranted liability. Turegum, 168 Ill. App. 3d at 163. At the same time, however, permitting the insurer to control the insured's defense may lead to problems. This is because, although an attorney retained by an insurer to represent its insured has ethical obligations to both parties, realistically he or she may have closer ties to the insurer and, consequently, a greater desire to protect the insurer's interests. Turegum, 168 Ill. App. 3d at 163. Of course, this is of no concern when the interests of the insurer and the insured are completely aligned. See, e.g., Clemmons v. Travelers Insurance Co., 88 Ill. 2d 469 (1981). But when those interests diverge, a problem arises. See, e.g., Murphy v. Urso, 88 Ill. 2d 444 (1981); Turegum, 168 Ill. App. 3d 158.

To determine whether there is a conflict, we must compare the allegations of the underlying complaint against the insured to the terms of the insurance policy at issue. Turegum, 168 Ill. App. 3d at 163. That complaint includes exhibits, such as contracts, which are attached to it. See Bianchi v. Savino Del Bene International Freight Forwarders, Inc., 329 Ill. App. 3d 908, 921 (2002). If, after comparing the complaint to the insurance policy, it appears that factual issues will be resolved in the underlying suit that would allow insurer-retained counsel to "lay the groundwork" for a later denial of coverage, then there is a conflict between the interests of the insurer and those of the insured. See Clemmons, 88 Ill. 2d at 479. Put another way, if, in the underlying suit, insurer-retained counsel would have the opportunity to shift facts in a way that takes the case outside the scope of policy coverage, then the insured is not required to defend the underlying suit with insurer-retained counsel. See Clemmons, 88 Ill. 2d at 475; Nandorf, Inc. v. CNA Insurance Cos., 134 Ill. App. 3d 134, 137 (1985). Rather, the insured is entitled to defend the suit with counsel of its choosing at the insurer's expense. See Nandorf, 134 Ill. App. 3d at 137 (noting that in conflict situations, "the insurer's obligation to defend is satisfied by reimbursing the insured for the costs of independent counsel").

Here, McNaughton argues, among other things, that there is a conflict because American Family's interests will be served if McNaughton is found liable in the Begy Suit for damage occurring prior to the inception of the Policy. The trial court rejected this argument, reasoning that (1) there was only a potential conflict, depending on what discovery in the Begy Suit showed; and (2) at this point, the interests of McNaughton and American Family are aligned, and they will diverge only if McNaughton is found liable. We take these points in reverse order.

With regard to the trial court's second point, it is not dispositive that McNaughton and American Family would both benefit from McNaughton's being found not liable in the Begy Suit. Indeed, an insurer and its insured will always have a shared interest in the insured's being absolved of liability. After all, if the insured is found not liable, then the insurer avoids the possibility of paying indemnification expenses down the road. But this is not the end of the inquiry. Instead, granting that the insurer and the insured have a shared interest in a finding of no liability, the question becomes whether the insurer's interest would be equally protected by a finding that would not be in the interest of the insured. If so, there is a conflict. See Murphy, 88 Ill. 2d at 453-54; Nandorf, 134 Ill. App. 3d at 138.

This is the lesson of the supreme court's decision in Murphy. There, a bus crashed, injuring a passenger. Murphy, 88 Ill. 2d at 448. The passenger sued both the bus driver and the bus owner. The passenger alleged that the owner was liable because the driver was using the bus with the owner's permission. Murphy, 88 Ill. 2d at 449. If that was the case, then the driver would be covered as a permissive user under the owner's insurance policy. If, however, the driver was using the bus without permission, the driver would not be covered. Because coverage potentially extended to the driver, the owner's insurer had a duty to defend the driver. Murphy, 88 Ill. 2d at 453.

The supreme court found that the situation involved a conflict. Murphy, 88 Ill. 2d at 453-54. Specifically, the court pointed out that both the driver and the insurer shared an interest in the driver's being found not liable, but that the insurer's interests would be equally protected if the driver were found to have used the bus without permission. Murphy, 88 Ill. 2d at 453-54. If he had, then the policy would not extend to the driver; in other words, the insurer could not be liable for any damages resulting from the driver's conduct.

Similarly, in the present case, both American Family and McNaughton share an interest in McNaughton's being found not liable for any damage to the Begys' home. But American Family's interests would be equally served if McNaughton were found liable for damage that occurred prior to the Policy's inception in 1994. Thus, here, as in Murphy, although the insurer and the insured share an interest, their interests also diverge. Therefore, there is a conflict.

American Family argues that Murphy is distinguishable from the present case. To this end, American Family points out that, in Murphy, the issue of permission would be resolved in the underlying suit against the owner and the driver, because the driver's alleged permission to use the bus was the basis on which the passenger sought to hold the owner liable for the driver's conduct. Conversely, American Family argues, in the present case the issue of the timing of the alleged damage to the Begys' home will not be resolved in the Begys' suit against McNaughton. Thus, American Family argues, Murphy does not support the conclusion that there is a conflict here.

There are two serious flaws in American Family's argument. First, the argument is inconsistent with the facts of this case. Although the Begys' complaint contains no dates (it alleges only poor workmanship and damages), the construction agreement between the Begys and McNaughton does contain dates (it states that work on the Begys' home was to occur during 1991 and 1992), and that agreement is attached to the Begys' complaint. As noted, exhibits attached to a complaint are considered to be part of that complaint. See Bianchi, 329 Ill. App. 3d at 921. Thus, American Family's argument that dates are not relevant to the underlying suit is factually inaccurate.

Second, American Family's argument makes no sense. According to American Family, the issues to be decided in the Begy Suit are limited to whether McNaughton performed work poorly and whether, as a result, the Begys' home was damaged. American Family argues that the question of when the alleged damage occurred is not relevant to the resolution of those issues. In other words, American Family argues that the Begys can prevail in a suit against McNaughton--a suit in which they allege that McNaughton's poor workmanship caused damage to their home--without establishing that the damage to their home stems from the time when McNaughton worked on their home. By that reasoning, a plaintiff could prevail in a suit claiming that he or she suffered injuries in a car crash, without having to establish that his or her injuries were related in time to the car crash. Put simply, that is absurd. Thus, for this reason too, we reject American Family's argument that dates are irrelevant in the Begy Suit.

Turegum further supports the conclusion that the trial court's reasoning on this point was mistaken. There, a patient was admitted to a hospital on three occasions, and she sued the hospital, alleging that, on one or more of those occasions, she received negligent treatment that caused her injury. Turegum, 168 Ill. App. 3d at 161. At the time of the patient's first admission, the hospital was covered by an insurance policy with Turegum. However, that policy lapsed prior to the patient's second and third admissions. Turegum, 168 Ill. App. 3d at 161. Nevertheless, because the policy potentially covered the hospital, Turegum had a duty to defend the hospital. At the same time, however, the court found that the situation involved a conflict. This was because Turegum's interest would be equally protected whether the hospital was found not liable or found liable for negligence occurring during the patient's second or third admission (that is, after the policy expired). Turegum, 168 Ill. App. 3d at 167-68.

Similarly, in this case, although McNaughton and American Family share an interest in McNaughton's being found not liable, American Family would do just as well if McNaughton were found liable for damage occurring before the inception of the Policy. Consequently, here, as in Turegum, there is a conflict.

Thus, the trial court erred in concluding that, because American Family and McNaughton shared some interests, there is no conflict. Having established as much, we turn to the trial court's first point, i.e., that there is no present conflict, but only a potential one depending on what is shown by discovery in the Begy Suit.

We disagree with that conclusion. A conflict already exists here. A conflict does not arise at the time a lack of coverage is unequivocally established. A conflict arises when the divergent interests of the insurer and insured are apparent and the attorney representing the insured can no longer represent both clients' interests without prejudice to either client. A conflict already exists here because American Family's interests would be served by fleshing out in discovery facts showing that the damage to the Begys' home occurred prior to the inception of the Policy, while McNaughton's interests would be served by fleshing out facts showing that the damage occurred after the inception of the Policy. In this regard, an attorney representing American Family's interests would be the enemy of McNaughton. As the supreme court has said, "[a] ruling that required an insured to be defended by what amounted to his enemy in the litigation would be foolish." Murphy, 88 Ill. 2d at 454-55. Thus, McNaughton should not be forced to use American Family's attorneys to defend against the Begys' claims.

American Family attempts to undermine this conclusion by characterizing the above conflict as merely "hypothetical." Such a hypothetical conflict, American Family says, cannot form the basis for a finding that there exists a conflict between an insurer and its insured entitling the latter to retain independent counsel at the expense of the former. American Family finds support for this position in Shelter Mutual Insurance Co. v. Bailey, 160 Ill. App. 3d 146 (1987).

In Shelter Mutual, the insured's policy excluded intentional acts. Shelter Mutual, 160 Ill. App. 3d at 155. The insured was sued for negligence only. The court noted that conflicts of interest have been found when a complaint alleged multiple theories of recovery against an insured, only some of which were covered by an insurance policy. Shelter Mutual, 160 Ill. App. 3d at 153-54. In those cases, the court explained, a conflict stemmed from the fact that the insurer's interest would be served if the insured were found liable under a noncovered theory. Shelter Mutual, 160 Ill. App. 3d at 155. However, the court found that the case before it did not fall into that category. This was because only one theory of recovery was alleged and liability based on that theory was covered by the policy. Shelter Mutual, 160 Ill. App. 3d at 155. The court rejected the idea that a conflict existed because the complaint, at least in theory, could be amended to include a claim that the insured acted intentionally (a claim, that is, that would not be covered by the policy). In doing so, the court reasoned that if, even though the complaint against the insured alleged only negligence, a potential conflict existed entitling the insured to hire his own attorney, "then in any negligence action an insured could claim that an intentional or wilful and wanton count could be added to the complaint at any time, thereby requiring the insurance company to turn the defense over to another attorney." Shelter Mutual, 160 Ill. App. 3d at 155.

Shelter Mutual is easily distinguished from the present case. Here, the "hypothetical" discovery to which American Family refers likely includes, among other things, questions relating to the timing of the alleged damage to the Begys' home. As discussed above, the question of the timing of the damage to the home will almost certainly come up in the underlying suit. Thus, there is no merit to American Family's suggestion that discovery relating to the theory of recovery alleged in the complaint is analogous to unpled, hypothetical theories of recovery. Accordingly, its reliance on Shelter Mutual is misplaced.

In sum, the trial court erred in finding that there was no conflict. Therefore, the trial court erred in finding that McNaughton was not permitted to retain its own legal counsel to defend it against the Begys' allegations at American Family's expense.[2]

III. CONCLUSION

For the reasons stated, the judgment of the circuit court of Du Page County is reversed, and the cause is remanded.

Reversed and remanded.

CALLUM and GILLERAN JOHNSON, JJ., concur

MOTIVA

UNITED STATES COURT OF APPEALS
For the Fifth Circuit

No. 05-20139

United States Court of App
Fifth Circuit
FILED

February 6, 2006

MOTIVA ENTERPRISES, LLC,

Plaintiff-Appellant

VERSUS

ST. PAUL FIRE AND MARINE INSURANCE COMPANY,

Defendant,

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA,

Defendant-Appellee.

Appeal from the United States District Court for the Southern District of Texas

Before REAVLEY, DAVIS and WIENER, Circuit Judges.

W. EUGENE DAVIS, Circuit Judge:

Plaintiff-Appellant Motiva Enterprises, L.L.C. ("Motiva") compromised an action brought against it for damages without notice to its insurer, Appellee-National Union. Motiva sued to recover the amount it paid in settlement, contending that it had no obligation to comply with the condition in the policy to obtain its insurer's consent to settle because National Union refused to tender an unqualified defense to Motiva. We agree with the district court that Motiva breached the policy, but we vacate the district court's take nothing judgment and remand the case to the district court to determine whether Motiva's breach prejudiced National Union.

I.

In July 2001, a sulfuric acid storage tank exploded at Motiva's Delaware refinery, killing one employee and injuring several others. A number of civil suits ensued, including a lawsuit by John and Pamela Beaver for injuries John sustained in the explosion (the "Beaver" suit).

Motiva had approximately $250 million in liability insurance which Motiva contended covered its liability for injuries and litigation costs related to the explosion. The coverage was divided into two "towers," referred to as the Continental Tower and the St. Paul Tower, and consisted of seven insurance policies in all. National Union supplied $25 million of umbrella coverage, providing for both the duty to defend and the duty to indemnify once the underlying insurance was exhausted. The policy contained standard "consent to settle" and "cooperation" clauses. The consent to settle clause required National Union's advance consent to any settlements that it would be funding,[1] and the cooperation clause required Motiva to cooperate with National Union in the investigation, settlement, and defense of claims.[2]

In July 2002, Motiva notified National Union of the first two lawsuits that had been filed against it, including the Beaver suit, and requested a defense. In February 2003, National Union conditionally disclaimed coverage on the ground that the underlying insurance policies had not yet been exhausted. National Union reserved the right to supplement or amend its disclaimer in the future. When National Union did not withdraw its denial of coverage at Motiva's request, Motiva filed suit seeking a declaratory judgment of its coverage.

In May 2003, National Union sent Motiva a "reservation of rights" letter that withdrew its disclaimer of coverage, but reserved the right to withhold or limit coverage under the terms

[1]The consent to settle clause specifically states: "No Insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent."

[2]The cooperation clause specifically states: "You and any other involved Insured must: ... cooperate with us in the investigation, settlement or defense of the claim or suit."

and conditions of the policy. On July 28, 2003, Motiva informed National Union that the St. Paul policy had been exhausted and that National Union would be responsible for the defense costs related to the remaining five suits. The next day, Motiva asked National Union to send a representative with full settlement authority to a mediation in the Beaver case that was scheduled for August 8, 2003. National Union immediately requested all documents related to Beaver, but on August 1, Motiva rejected the request, claiming that National Union had "never acknowledged coverage" for the Beaver claim. Despite that refusal, Motiva still demanded that National Union attend the mediation.

On August 6, National Union tendered its offer to defend the Beaver case and the other pending lawsuits, subject to a reservation of its right to deny coverage under the terms of the policy. National Union asked Motiva to cooperate fully with its defense - a requirement of the policy - and said that it expected to participate fully in the Beaver mediation. Despite the tender, Motiva refused to furnish the Beaver documents to National Union.

On August 8, National Union sent a representative to the mediation. During National Union's presence at the mediation, the only settlement demand it received was for $40 million. Before the mediation ended however, National Union was asked to leave. The mediation continued without National Union's presence and ultimately resulted in a voluntary settlement agreement in which

Motiva agreed to pay $16,500,000 to resolve the claim.

After the mediation, Motiva asked National Union to fund the settlement, but National Union refused to do so on the grounds that its consent had not been obtained as required by the consent to settle clause. Motiva paid the settlement out of its own funds and after National Union again declined Motiva's request for reimbursement, Motiva filed this suit to recover sums it paid to settle the Beaver claim.

In December 2003, the parties submitted a Stipulated Chronology and Facts per the district court's order. National Union and Motiva filed cross-motions for summary judgment, and on August 26, 2004, the district court granted partial judgment for National Union, holding that Motiva should take nothing in the lawsuit because it had breached the consent to settle and cooperation clauses.

Following the district court's partial judgment in favor of National Union, Motiva filed a Motion for Reconsideration and to Amend Judgment and attached several affidavits contradicting the facts in the summary judgment record as interpreted by the district court. National Union filed a response in opposition and a motion to strike the affidavits as offering newly alleged facts. The district court denied Motiva's Motion for Reconsideration and to Amend Judgment and stated that Motiva could not supplement the record with new facts.

Reviewing the district court's grant of summary judgment *de novo*, we consider each of Motiva's arguments below.

II.

A.

Motiva argues first that the district court erred in allowing National Union to deny policy benefits to its insured based on breaches of consent to settle and cooperation clauses when National Union had not tendered an unqualified defense to Motiva. In other words, Motiva argues that when National Union's tender of a defense was subject to its reservation of rights to later deny coverage, Motiva was entitled to settle the Beaver claim without consulting National Union.

Motiva relies on our decision in Rhodes v. Chicago Ins. Co., 719 F.2d 116 (5th Cir. 1983) for its argument that under Texas law, National Union's reservation of rights released Motiva from the constraint of the "consent to settle" clause. Motiva correctly quotes our statement that "[i]f the insurer properly reserved its rights and the insured elected to pursue its own defense, the insurer is bound to pay damages which resulted from covered conduct and which were reasonable and prudent up to the policy limits." Id. at 121. Motiva also recites our statement in Rhodes that in such a situation, "the insured is not constrained by conditions in the policy which limit the insured's ability to settle the claim, and the insurer cannot complain about the insured's conduct of the

defense." Id.

Unfortunately for Motiva, our holding in Rhodes was an "Erie guess" by us and has since been undermined by the Texas Supreme Court's decision in State Farm Lloyds Ins. Co. v. Maldonado, 963 S.W.2d 38 (Tex. 1998). In Maldonado, State Farm tendered a defense with a reservation of rights to its insured, Robert, who had been sued for defamation by a former employee, Maldonado. When State Farm would not pay Maldonado's settlement demand, Maldonado and Robert entered into a private agreement in which Maldonado discharged Robert from further personal liability for Maldonado's damages. Robert, no longer having any incentive to contest the defamation claim at trial, failed to actively defend the claim through his attorney provided by State Farm. He did not present any evidence, cross-examine any witnesses, or present opening or closing arguments.

The trial resulted in a verdict in favor of Maldonado. State Farm denied coverage and contended that the trial constituted a breach of the "actual trial" condition of its insurance policy[3] and relieved State Farm of its duty to indemnify. The Texas Supreme Court agreed, holding that "[b]ecause State Farm agreed to defend Robert under a reservation of rights and Robert failed to satisfy a condition precedent of the insurance policy, Robert cannot sue or recover on the policy." Id. at 40.

Under Erie, we are, of course, obliged to decide questions of state law as we believe the state supreme court would decide the issue. Although a different policy condition was at issue in Maldonado, we see no principled basis to distinguish it from today's case. We conclude therefore that under Maldonado, an insurer which tenders a defense with a reservation of rights is entitled to enforce a consent to settle clause, and our holding in Rhodes does not accurately reflect current Texas law. The district court therefore did not err in holding that Motiva breached its insurance policy by settling without National Union's consent, even though National Union reserved its right to contest coverage and therefore did not tender to Motiva an unqualified defense.

B.

The district court found that Motiva breached the cooperation clause by asking National Union to leave the Beaver mediation. Motiva challenges this conclusion. The only summary judgment evidence on this point is a letter sent after the mediation from National Union's attorney to Motiva's attorney complaining that National Union was "brashly asked" to leave the mediation.

Even if this letter of complaint by National Union supports the inference that Motiva asked the insurer's counsel to leave the mediation, we are not persuaded that this isolated fact amounts to a breach of the cooperation clause. We have no facts or circumstances surrounding Motiva's alleged request to National Union's counsel to leave the mediation, or what significance the event had in the eventual outcome of the case and whether it operated to National Union's prejudice. We conclude that questions of fact are presented on whether National Union breached the cooperation clause, and if it did breach the clause, whether the failure to cooperate operated to National Union's prejudice.

C.

Motiva argues next that even if it breached the consent to settle or cooperation clauses in the National Union policy, National Union cannot refuse to pay the benefits unless it shows actual prejudice from the breach. We agree.

The Texas Supreme Court held in Hernandez v. Gulf Group Lloyds, 875 S.W. 2d 691, 692 (Tex. 1994), that an insurer may escape liability on the basis of a settlement-without-consent exclusion only when the insurer is actually prejudiced by the insured's settlement. The court based its holding on general principles for interpreting contract law and observed that "when one party to a contract commits a material breach...the other party is discharged...from any obligation to perform." Id. at 692. In determining the materiality of the breach, the court observed that it must consider *inter alia* "the extent to which the non-breaching party will be deprived of the benefit that it could have reasonably

[3] The "actual trial" condition provided that "[a] person or organization may sue [State Farm] to recover on ...a final judgment against an insured obtained after an actual trial." 963 S.W.2d at 40.

anticipated from full performance." Id. at 693. In Ridglea Estate Condo. Ass'n v. Lexington Insurance. Co., 415 F.3d 474 (5th Cir. 2005), a panel of this court recently applied Hernandez and held that Texas law requires that an insurer show prejudice resulting from the insured's breach of a condition in the policy to defeat the insured's claim to policy proceeds.

Although the district court made a brief reference to prejudice in its opinion, it did not consider the actual, concrete prejudice an insurer must show to avoid payment. We therefore must remand this case to the district court for a determination of whether National Union breached the cooperation clause, and whether it suffered actual, concrete prejudice[4] from Motiva's breach of any policy condition.

III.

For the reasons stated above, we vacate the district court's judgment ordering that Motiva take nothing and remand for further proceedings consistent with this opinion.

VACATED and REMANDED.

[4]For example, can National Union show that Motiva had no liability or that it had no coverage or that the breach prevented it from asserting a valid defense to liabilty or coverage or that the settlement was unreasonable.

McGREGOR

*2005 Mass. Super. LEXIS 636, **

Thomas McGregor v. Allamerica Insurance Company

Opinion No.: 91642, Docket Number: WOCV04-1001

SUPERIOR COURT OF MASSACHUSETTS, AT WORCESTER

2005 Mass. Super. LEXIS 636

December 15, 2005, Decided
December 19, 2005, Filed

Leila R. Kern, Justice of the Superior Court.

MEMORANDUM OF DECISION AND ORDER ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT AND PLAINTIFF'S CROSS MOTION FOR SUMMARY JUDGMENT

The plaintiff, Thomas McGregor, filed this action for declaratory judgment and breach of contract against the defendant, Allamerica Insurance Company. McGregor seeks coverage from Allamerica for property damage and cleanup costs associated with a discharge of oil. The matter is before this court on Allamerica's Motion for Summary Judgment and McGregor's Cross Motion for Summary Judgment. Both parties assert that there are no material facts for trial and coverage of the underlying claim can be determined from the language of the commercial general liability insurance policy as a matter of law. For the reasons set forth below, Allamerica's Motion for Summary Judgment is *DENIED* and McGregor's Cross Motion for Summary Judgment is *ALLOWED.*

BACKGROUND

The following are the undisputed material facts from the summary judgment record.

McGregor is in the business of installing and servicing oil burners and heating equipment for residential properties. Allamerica issued McGregor a [*2] commercial general liability insurance policy, with effective dates from September 22, 2000 to September 22, 2001.

On or about December 21, 1994, McGregor installed a new oil burner and heating system in the basement of property owned by Peter and Susan Staecker. In February 2001, the Staeckers discovered that the oil supply tank was empty and that there was a leak in the oil supply line, causing the contents of the oil tank to run into the ground. On or about February 13, 2001, the Massachusetts Department of Environmental Protection issued a Notice of Responsibility to the Staeckers, based on the "release or threat of release of oil and/or hazardous material." The Notice directed the Staeckers to undertake the assessment, containment and remediation of the environmental contamination caused by the oil leak.

On or about July 18, 2002, Merrimack Mutual Fire Insurance Company and Liberty Mutual Insurance Company, as subrogees of the Staeckers, brought an action against McGregor alleging that McGregor negligently installed the oil burner causing oil to leak into the ground. The suit sought recovery from McGregor of the costs of the cleanup.

McGregor notified Allamerica of the Staeckers' [*3] claim. Allamerica refused to defend McGregor, asserting that the "Total Pollution Exclusion With a Building Heating Equipment Exception and a Hostile Fire Exception" endorsement put the claim outside of the losses covered by the policy. Thereafter, McGregor filed this declaratory action against Allamerica to determine the parties' rights and obligations under the policy.

DISCUSSION

This court grants summary judgment when there are no genuine issues of material fact and where the summary judgment record entitles the moving party to judgment as a matter of law. See Mass.R.Civ.P. 56(c); *Cassesso v. Comm'r of Corr.*, 390 Mass. 419, 422, 456 N.E.2d 1123 (1983). The moving party bears the burden of establishing both that there is no genuine issue of material fact and that the moving party is entitled to summary judgment as a matter of law. *Pederson v. Time, Inc.*, 404 Mass. 14, 17, 532 N.E.2d 1211 (1989). A party moving for summary judgment who does not bear the burden of proof at trial may demonstrate the absence of a triable issue by either submitting affirmative evidence negating an essential element of the nonmoving party's case or by showing that the [*4] moving party has no reasonable expectation of proving an essential element of its case at trial. *Kourouvacilis v. Gen. Motors Corp.*, 410 Mass. 706, 716, 575 N.E.2d 734 (1991).

The issue raised by the motions for summary judgment is whether the spill of oil at the Staeckers' home falls within the Total Pollution Exclusion of the policy. Allamerica contends that the Total Pollution Exclusion endorsement bars coverage, thus it had no duty to defend McGregor. In opposition, McGregor maintains that the exclusion does not bar coverage on the grounds that an objectively reasonable insured would not expect a disclaimer of coverage for damages caused by a broken oil burner.

The interpretation of language within an insurance contract is a question of law for the court. See *Affiliated FM Ins. Co. v. Constitution Reinsurance Corp.*, 416 Mass. 839, 842, 626 N.E.2d 878 (1994); *Cody v. Connecticut General Life Ins. Co.*, 387 Mass. 142, 146, 439 N.E.2d 234 (1982). When faced with such issues, the court's interpretation of the policy is governed by common-law rules of contract construction. See *Citation Ins. Co. v. Gomez*, 426 Mass. 379, 381, 688 N.E.2d 951 (1988); *Sherman v. Employers' Liab. Assurance Corp.*, 343 Mass. 354, 357, 178 N.E.2d 864 (1961). [*5] "When construing language in an insurance policy, [courts] 'consider what an objectively reasonable insured, reading the relevant policy language, would expect to be covered.' " *Atlantic Mut. Ins. Co. v. McFadden*, 413 Mass. 90, 92, 595 N.E.2d 762 (1992) (quoting *Hazen Paper Co. v. United States Fid. & Guar. Co.*, 407 Mass. 689, 700, 555 N.E.2d 576 (1990)).

When an insurance contract is deemed ambiguous, Massachusetts courts interpret it in a manner most favorable to the insured. See *Citation Ins. Co.*, 426 Mass. at 381. Further, Massachusetts courts generally define ambiguity as the presentation of more than one meaning to a contract term which reasonable people would interpret differently. *Id.* at 381. If there is not ambiguity presented in the policy language, the court views the words in their ordinary sense. See *Hakim v. Massachusetts Insurers' Insolvency Fund*, 424 Mass. 275, 675 N.E.2d 1161 (1997).

The Total Pollution Exclusion, which is the principal subject of this controversy, reads in pertinent part as follows:

This insurance does not apply to:
F. Pollution

1) "Bodily injury" or "property damage" which would not have occurred [*6] in whole or part but for the actual alleged or threatened discharge, dispersal, seepage, migration, release or escape of "pollutants" at any time.

****

2) Any loss, cost or expense arising out of any:

a) Request, demand, order of statutory or regulatory requirement that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of "pollutants"; or

b) Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of, "pollutants."

The policy defines "pollutants" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

The Supreme Judicial Court interpreted total pollution exclusion language substantially similar to that involved here in both *McFadden* and *Gill*. In *Atlantic Mutual Ins. Co. v. McFadden*, 413 Mass. 90, 595 N.E.2d 762 (1992), the insurer alleged that a pollution exclusion provision excused its duty to [*7] defend or indemnify its insured against an action for damages arising out of the lead poisoning of children on private property leased by the insured. The court held that the pollution exclusion provision did not excuse coverage for the underlying claims. *Id.* at 92. In making this determination, the court considered what a reasonable insured could have understood the exclusion to mean and concluded that although an insured could have understood the exclusion to apply to certain injuries, the reasonable insured would not have concluded that coverage was excluded for personal injury caused by the presence of lead paint in the house. *Id.*

In *Western Alliance Ins. Co. v. Gill*, 426 Mass. 115, 120-21, 686 N.E.2d 997 (1997), the court held that a pollution exclusion clause did not exclude coverage for personal injuries resulting from exposure to carbon monoxide gas from a malfunctioning restaurant oven. The court stated:
The exclusion should not reflexively be applied to accidents arising during the course of normal business activities simply because they involve a "discharge, dispersal, release or escape" of an "irritant or contaminant."

Id. at 118. [*8] In reaching its conclusion, the court discussed a number of nationwide cases that found that an "objectively reasonable insured reading the language of a typical pollution exclusion, would not expect a disclaimer of coverage for . . . mishaps even though they involve 'discharges,' 'dispersals,' 'releases,' and 'escapes' of 'contaminants' and 'irritants.' " *Id.* at 120. The court stated that the "common thread" between those decisions were that they "all involve injuries resulting from everyday activities gone slightly, but not surprisingly, awry." *Id.* at 119.

In *E. Cas. Ins. Co. v. The Home Store, Inc.*, Civil No. 5323 (Middlesex Super.Ct. May 20, 2005) (Gailey, J.) (19 Mass. L. Rptr. 363), a case factually similar to the case at bar, the insured installed an oil-fired heating system in a private residence. A valve in the oil-fired heating system failed and oil leaked onto the basement floor of the home, and eventually into the underlying soil, causing significant property damage. The insurance company asserted that it properly denied coverage for the claim because of the total pollution exclusion provision contained within the policy. [*9] The court stated that "critical to whether the exclusion applies is the context in which the damages occur." The court applied the reasoning of *McFadden* and *Gill* and rejected the insurance company's claim that the pollution exclusion provision eliminated its obligation to defend and indemnify the defendant from the homeowners' claim. The court stated that "an objectively reasonable insured, reading the language of the pollution exclusion, would not expect a disclaimer of coverage for

damages caused by a broken home furnace."

This court finds the reasoning employed in *Home Store* persuasive. n1 In the instant case, the leak in the oil burner was an isolated accident, in a private residence, that arose during the course of McGregor's normal business activities. The damages resulted from McGregor's activities "gone slightly, but not surprisingly, awry." As stated in *Home Store*, the damages "did not involve pollution in an industrial context, or a discharge of oil or other contaminants into the ground as part of [McGregor's] industrial process." Rather, the damages involved a broken oil-burner. This court finds that an objectively reasonable insured, reading the language [*10] of the pollution exclusion, would not expect a disclaimer of coverage for damages caused by a broken oil burner. Accordingly, the Total Pollution Exclusion did not relieve Allamerica of its obligation to defend and indemnify McGregor from the underlying claims in this case.

- - - - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

n1 Although the facts of *Wagner Bros., Inc. v. The Commerce Ins. Co.*, Civil No. 20001575 (Worcester Super.Ct. March 22, 2002) (Hillman, J.) (14 Mass. L. Rep. 476), are also similar to the instant case, this court finds the reasoning in *Home Store*, with its reliance on *McFadden* and *Gill,* more persuasive.

- - - - - - - - - - - - End Footnotes- - - - - - - - - - - - - -

ORDER

For the foregoing reasons, Allamerica's Motion for Summary Judgment is *DENIED* and McGregor's Cross Motion for Summary Judgment is *ALLOWED.*

Leila R. Kern

Justice of the Superior Court

DATED: December 15, 2005

Long Is. Light. Co. v Allianz Underwriters Ins. Co.
2005 NY Slip Op 09402
Decided on December 8, 2005
Appellate Division, First Department
Published by New York State Law Reporting Bureau pursuant to Judiciary Law § 431.
This opinion is uncorrected and subject to revision before publication in the Official Reports.

Decided on December 8, 2005
Andrias, J.P., Saxe, Ellerin, Sweeny, Catterson, JJ.
5216 Index 604715/97

[*1]Long Island Lighting Company, Plaintiff, KeySpan Corporation, etc., Plaintiff-Appellant,

v

Allianz Underwriters Insurance Company, et al., Defendants, Century Indemnity Company, et al., Defendants-Respondents.

Dickstein Shapiro Morin & Oshinsky LLP, New York (David L. Elkind of counsel), for appellant.
Siegal, Napierkowski & Park, Cherry Hill, NJ (Lawrence A. Nathanson, of the New Jersey Bar, admitted pro hac vice, of counsel), for Century Indemnity Company, respondent.
Skadden, Arps, Slate, Meagher & Flom, New York (Michael J. Balch of counsel), for General Reinsurance Corporation, respondent.

Order, Supreme Court, New York County (Ira Gammerman, J.), entered on or about January 8, 2004, which, in a declaratory judgment involving insurance coverage for certain environmental cleanup costs, upon defendants-respondents' motions for partial summary judgment declaring that their policies do not cover losses at the Syosset Landfill site due to plaintiffs' failure to comply with the notice provisions in their respective policies, insofar as appealed from, dismissed plaintiff-appellant's claims for coverage in connection with the Syosset Landfill site, modified, on the law, to declare that defendants-respondents are not obligated to defend or indemnify plaintiffs in connection with the Syosset Landfill site, and otherwise affirmed, without costs.

Plaintiff failed to satisfy its obligation under the subject policies to give notice upon the happening of an occurrence "reasonably likely" to involve the policies. Such occurrence happened not when plaintiff was sued in the underlying action some five weeks before giving defendants notice of the Syosset claim, but almost six months earlier, when plaintiff received a letter from the underlying plaintiff's lawyer threatening a lawsuit over the Syosset site (*see Christiania Gen. Ins. Corp. v Great Am. Ins. Co.*, 979 F2d 268, 276 [2d Cir 1992]). We reject plaintiff's argument that there was a reasonable possibility that the subject policies, both excess, would not be reached by the Syosset claim, where plaintiff offers no evidence that the timing of [*2]its notice was the result of a deliberate determination to that effect, and not, as the record suggests, the belief that it was not responsible for the Syosset cleanup costs. Nor does it avail plaintiff to argue that defendants were not prejudiced by the late notice (*see Great Canal Realty Corp. v Seneca Ins. Co.*, 5 NY3d 742 [2005]; *Argo Corp. v Greater N.Y. Mut. Ins. Co.*, 4 NY3d 332, 339 [2005]; *Security Mut. Ins. Co. of N.Y. v Acker-Fitzsimmons Corp.*, 31 NY2d 436, 440 [1972]; *see also Matter of Brandon [Nationwide Mut. Ins. Co.]*, 97 NY2d 491, 496, n3 [2002]).

All concur except Ellerin and Catterson, JJ. who dissent in a memorandum by Catterson, J. as follows:

CATTERSON, J. (dissenting)

Because I believe genuine issues of material fact exist, I respectfully dissent. Specifically, I believe the motion court improperly determined, as a matter of law, that notice to excess insurers Century Indemnity Company (hereinafter referred to as "Century") and General Reinsurance Corporation (hereinafter referred to as "General Re") was triggered by plaintiff's receipt of a form letter sent by the Town of Oyster Bay (hereinafter referred to as "Town") to 37 Long Island companies in September 1993.

Initially, both excess insurer defendants asserted that the obligation to give notice arose in 1990 when the Long Island Lighting Company (hereinafter referred to as "LILCO") was informed by the Environmental Protection Agency (hereinafter referred to as "EPA") that it was a potentially responsible party. LILCO, on the other hand, claimed that the notice obligation was triggered only after the Town winnowed out the list of 37 and commenced a lawsuit against just 15 of those companies.

Factual issues, therefore, remain as to what LILCO reasonably believed regarding its liability after receipt of the 1993 letter. Factual issues also exist as to when LILCO reasonably believed that the Town's claim would implicate the excess policies. For these reasons I cannot agree that as a matter of law LILCO failed to comply with the subject notice provisions.

The underlying lawsuit in this declaratory judgment action involves the accumulation of hazardous waste at the Syosset landfill operated by the Town from 1933 to 1975. LILCO and its successor in interest, Keyspan Corporation, used the landfill from 1954 until 1975, when the landfill was closed by the Nassau County Department of Health.

On February 2, 1989, EPA advised LILCO in writing that it had "documented the release of hazardous substances at the Syosset landfill site," and requested information from LILCO "[t]o ascertain the nature of the materials you generated, treated, transported and/or disposed of." By a letter dated March 3, 1989, LILCO advised the EPA that between the years 1954 and 1975, the only material it was aware it had deposited at the landfill was "construction and demolition waste."

EPA and LILCO continued corresponding until August 3, 1990, when the EPA sent LILCO a copy of the "Superfund Proposed Plan for the Syosset Landfill Superfund Site." The proposal listed plans with varying costs for the clean-up, with a cost of $26.2 million dollars for [*3]the plan favored by the EPA.

Approximately three years later, on September 3, 1993, the Town sent a letter to LILCO asserting that LILCO, along with others, was liable under federal and state statutes for all or a portion of the costs of the clean-up which was ongoing [FN1]. Attached to the letter was a list of 37 other Long Island companies, which the Town described as "parties [also] receiving notice of the Town's claim."

On February 18, 1994, the Town commenced a lawsuit in the United States District Court for the Eastern District of New York against just 15 of those companies, including LILCO, seeking, *inter alia*, a declaration that the defendants were obligated to pay for clean-up and removal costs at the landfill. On March 25, 1994, LILCO informed its various insurers, including the defendants Century and General about the lawsuit.

Century and its predecessor companies had issued eight excess liability policies to LILCO during the period between 1957 and 1966. The self-insured retention varied from $25,000 in the 1957 policy to $100,000 in the 1962-1966 policies. General Re issued four upper-layer excess policies to LILCO from 1954 to 1966.

In the letter of March 25, 1994, LILCO requested of Century and General Re, as it did of its other insurers, that they provide defense costs and indemnification. LILCO informed all the carriers that it had retained attorneys to defend it in a lawsuit where a finding against any or all of the defendants raised the possibility of joint and several liability. Subsequently, LILCO brought this declaratory judgment action against all the insurers who failed to respond positively.

Several defendant carriers, other than Century and General Re, moved to dismiss the complaints. The motion court dismissed them, concluding that because the coverage provided by the primary carriers and the self-insured retention would not be exceeded to reach the coverage provided by these carriers, the claims against these carriers were not justiciable. The complaints against other carriers were dismissed for other reasons, including bankruptcy.

In June and July 2000, Century and General Re moved and cross-moved for partial summary judgment. Both asserted that LILCO's obligation to give notice arose in 1990, upon being advised by the EPA that LILCO was identified as a potentially responsible party. LILCO claimed that it did not appear "reasonably likely" that it faced liability until the Town commenced its lawsuit against multiple defendants including LILCO in February 1994 and that, therefore, its notice to both insurers was timely. More significantly, LILCO argued that the allocation of losses among the various insurers over the life of the landfill was a relevant inquiry because such inquiry would demonstrate which of the excess policies were implicated, and thus when the notice to those excess insurers would have been necessary.

New York law unfortunately provides that because "notice provisions in insurance policies afford the insurer an opportunity to protect itself [ ] [a]bsent a valid excuse, a failure to satisfy the notice requirement vitiates the policy, and the insurer need not show prejudice before it can assert the defense of noncompliance." *Security Mutual Insurance Co. v. Acker-[*4]Fitzsimmons Corp.*, 31 N.Y.2d 436, 440, 340 N.Y.2d 902, 905, 293 N.E.2d 76, 78 (1972)[FN2]. The motion court's determination that LILCO failed to comply with the notice provisions was made on the basis that, after receipt of the 1993 letter, LILCO should have gleaned that there was a "reasonable possibility" of the policies' involvement. The court held that, as of that date, "LILCO knew that the Town of Oyster Bay would hold it responsible for the materials disposed of at the landfill, and that this potential liability could be as much as $26.2 million."

The relevant factual inquiry here is the reasonableness of LILCO's beliefs about its liability at the time of the letter. In particular, questions arise as to whether it was reasonable for LILCO to believe, after receipt of the 1993 letter, that it would be liable, and if so whether LILCO believed that the Town's claim would implicate the excess policies.

The well-settled law of this jurisdiction is that an insured's delay or failure to give timely notice may be excused where the insured has a reasonable belief that it would not be liable. *Paramount Ins. Co., v. Rosedale Gardens Inc.*, 293 A.D.2d 235, 239, 743 N.Y.S.2d 59, 62 (2002). At issue is not whether an insured believes that he or she will ultimately be found liable but whether he or she has a reasonable basis for a belief that no claim will be asserted against him or her. *SSBSS Realty v. Pub. Serv. Mut. Ins. Co.*, 253 A.D.2d 583, 584, 677 N.Y.S.2d 136, 138 [1998]).

In this case, LILCO asserts that the 1993 letter was sent after a three-year period of silence on the issue of the landfill; that there was no communication between EPA, the Town and LILCO during that period; and that the letter reiterated the Town's belief that LILCO had arranged for the disposal of hazardous substances at the site but the Town offered no factual basis for that claim or any additional facts whatsoever. LILCO contends that the letter appeared to be no more than a form letter that was also sent to 37 other Long Island companies more than half of which were subsequently not named as defendants in the lawsuit commenced by the Town. Thus, LILCO maintains that a question of fact exists as to whether it was reasonable for it to believe that no claim would be asserted against it.

Further, LILCO argues that the defendants fail to distinguish between notice obligations under primary policies and those under excess policies. It argues that the issue is whether it appeared likely, before the commencement of the lawsuit, that the company would face sufficient liability to implicate the excess policies.

The landmark case of *American Home Assur. Co. v. Intl. Ins. Co.*, 90 N.Y.2d 433, 661 N.Y.S.2d 584, 684 N.E.2d 14 (1997), extended the no-prejudice exception to excess insurers, holding that they have the same interests as primary insurers, and that therefore, notice provisions apply equally where they are concerned. The Court noted the difference between primary insurance coverage and excess insurance coverage by observing that the term 'primary' insurance is "used to distinguish the coverage that is *immediately* triggered upon a defined occurrence from 'excess' insurance, i.e. coverage which is triggered only after the former is exhausted." *Id.* at [*5]441, 661 N.Y.S.2d at 587, n.2 (emphasis added), *citing American Home Assur. Co. v. Republic Ins. Co.*, 984 F.2d 76, 77 (2d Cir. 1993), *cert denied*, 508 U.S. 973, 113 S.Ct. 2964, 125 L.Ed.2d 664 (1993). By logical extension, as the plaintiff asserts, the obligation to provide notice to an excess insurer does not arise at the same time as does the obligation to provide notice to a primary insurer, (that is upon the happening of an occurrence or event likely to give rise to a claim), but upon the insured "reasonably concluding" that a covered occurrence is likely to "trigger" the excess policy. *See Olin Corp. v. Am. Re-Insurance Co.*, 2003 WL 22048230, *2, 2003 U.S. App LEXIS 18209, *5-6 (2d Cir. 2003).

Indeed, the facts of *American Home*, 90 N.Y.2d 433, *supra*, support this conclusion. The case involved a fire in which a family of five perished after its gas furnace was improperly installed by the insured, Mobil Gas. Within days of the accident in December 1985, attorneys for Mobil notified its primary insurer, Liberty Mutual, of total culpability and "horrendous damages" which would exceed $5 million. The primary insurance policy provided coverage up to $300,000, but it took more than six weeks before American Home Assurance, the first level excess insurer, was informed of the accident. Nevertheless, there was no disclaimer of coverage by American on the basis of late notice.[FN3]

Federal courts applying New York law on notice requirements have concluded that "an insured's obligation to notify its excess carriers is slightly different from the obligation to notify its

primary carrier." *Green Door Realty Corp. v. TIG Ins. Co.*, 329 F.3d 282, 288 (2003), *citing Olin Corp v. Ins. Co. Of N. Am.*, 743 F. Supp. 1044 (S.D.N.Y. 1990), *affd*, 929 F.2d 62 (2d Cir. 1991). In effect, excess and primary insurance policies have "different notice accrual points." *Olin Corp. v. Am. Re-Insurance Co.*, *supra*, *citing American Assur. Co. v. Republic Ins. Co.*, 984 F.2d at 77.

Thus, in determining whether LILCO's notice to its excess insurers was timely, an additional question of fact exists as to whether LILCO demonstrated a reasonable belief that the claims were not of "sufficient magnitude to penetrate through the primary coverage and reach the excess policies." *Olin Corp., v. Am. Re-Insurance*, 2003 WL 22048230 at *2, 2003 U.S. App LEXIS 18209 at *7. LILCO claims that relevant to making the assessment as to whether any excess policies would be implicated at all is a calculation based on the spread of the damages over the number of policy years. The trial court rejected the argument although the court itself used the method of spreading the worst-case estimate of damages across the policy years at issue to initially determine which excess insurers would not be reached, and thus who could be dismissed from LILCO's declaratory judgment action. LILCO's assertion that taking the spread into account is absolutely essential to the determination of whether a notice obligation arose upon receipt of the 1993 letter is supported by the observation that when a notice obligation is triggered only by a claim that is *reasonably likely to implicate* a given policy, the insured must necessarily weigh all the factors that would affect the policy being implicated. In this case, LILCO maintains that a finder of fact could reasonably have concluded that it did not appear [*6]likely that a claim spread among the decades of triggered policies would reach any of the excess policies at issue. Additionally, whether LILCO's belief about the implication of its excess policies was, in fact, based on any such assessment is another question for the finder of fact, and should not have been resolved by the court on summary judgment. *Argentina v. Otsego Mut. Fire Ins. Co.*, 86 N.Y.2d 748, 750, 631 N.Y.S.2d 125, 126, 655 N.E.2d 166, 167 (1995) (whether a good-faith belief exists and whether that belief is reasonable under the circumstances are ordinarily questions for the finder of facts).

For the foregoing reasons I disagree with the majority decision granting partial summary judgment to the defendants and dismissing the plaintiff's claims for coverage in connection with the underlying lawsuit.

THIS CONSTITUTES THE DECISION AND ORDER
OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: DECEMBER 8, 2005

CLERK

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NORTH CAROLINA
WESTERN DIVISION

No. 5:01-CV-819-BR(3)

AUTO-OWNERS INSURANCE COMPANY,

Plaintiff,

v.

WHITEWOOD PROPERTIES, INC., d/b/a NEUSE CROSSING UTILITIES COMPANY and d/b/a NEUSE CROSSING UTILITIES COMPANY PROPERTIES, JAMES D. ADAMS, JR., and DEBRA J. POTTER, et al.,

Defendants.

ORDER

WHITEWOOD PROPERTIES, INC., d/b/a NEUSE CROSSING UTILITIES COMPANY and JAMES D. ADAMS, JR.,

Third-Party Plaintiffs,

v.

THE HARLEYSVILLE INSURANCE COMPANIES,

Third-Party Defendants.

The Potter litigants' motion for summary judgment and a motion for an order of dismissal submitted by Auto-Owners Insurance Company (Auto-Owners) and Whitewood Properties, Inc. (Whitewood) are before the court.

Procedural History

On 28 March 2003, this court entered an Order allowing summary judgment in favor of Auto-Owners, holding that Auto-Owners did not have a duty to defend Whitewood Properties,

Inc. d/b/a Neuse Crossing Utilities Company and James D. Adams, Jr. (hereinafter, collectively Whitewood) in the action filed against them by the Potter litigants in state court.

On 14 April 2003, Auto-Owners requested the court to enter final judgment on its behalf, and the court did so on 27 May 2003. The Potter litigants and Whitewood appealed. After providing notice to Whitewood of its intent to do so, Auto-Owners withdrew its defense of Whitewood on or about 1 June 2003, (Potter Litigants' 2 March 2005 Mem., Ex. 7). Whitewood subsequently notified Auto-Owners of its intent to settle the underlying matter with the Potter litigants and requested that Auto-Owners resume its defense of Whitewood. Auto-Owners again denied coverage based on this court's Order in its favor. Auto-Owners objected to the proposed settlement agreement and explained to Whitewood that its policies explicitly prohibited the assumption of obligations by an insured without the consent of the insurer. Nevertheless, on or about 28 October 2003, Whitewood entered an agreement with the Potter litigants settling the underlying state court action, pursuant to which Whitewood agreed to pay the Potter litigants six million dollars, (Potter Litigants' 2 March 2005 Mem, Ex. 8). The presiding North Carolina Superior Court judge and a hearing officer of the Wake County Clerk's office approved the settlement between Whitewood and the Potter litigants (hereinafter "the 2003 Agreement"). (Auto-Owners' Verified Motion, Ex. H, attachments (Order Approving Settlement and Settlement Agreement).)

On 27 July 2004, a year and four months after this court's summary judgment decision and ten months after the 2003 Agreement, the Fourth Circuit held that the pollution exclusion clause of the insurance policies at issue did not constitute a complete bar to coverage, vacated this court's grant of summary judgment, and remanded the case for further examination of the

scope of the pollution exclusion clause and other applicable limitations and exclusions. The mandate issued on 1 September 2004 after a petition for rehearing was denied, and the case was reopened on 8 September 2004.

On 8 September 2004, the Potter litigants filed an answer to Auto-Owner's amended complaint along with a counterclaim against Auto-Owners seeking to enforce Auto-Owners' indemnity obligation with respect to Whitewood's settlement of the underlying state case. Auto-Owners filed an answer to the counterclaim on 8 October 2004.

On 2 March 2005, the Potter litigants filed this motion for summary judgment with a supporting memorandum, asking the court to grant summary judgment against Auto-Owners on all policy exclusions and coverage defenses asserted in Auto-Owners' declaratory judgment action and in favor of the Potter litigants with respect to their counterclaim to enforce Auto-Owners' indemnification obligation. In an attempt to limit the issues before the court on summary judgment and obtain a period of discovery, Auto-Owners submitted on 22 March 2005 a "Verified Motion for an Order Limiting the Issues for Summary Judgment to those on Remand and to Extend Discovery" (the verified motion). Upon consideration of the verified motion and supporting and responsive documents submitted by all parties, the court determined that it would address the summary judgment motion as presented by the Potter litigants but that it would do so in parts, beginning with the duty to defend issues raised by the Fourth Circuit's remand of this court's 2003 Order. (See 25 April 2005 Order at 4-5.) Auto-Owners submitted a brief in response to the Potter litigants' motion for summary judgment pertaining to the duty to defend issues as instructed by the court on 16 May 2005. With leave of court, Whitewood also filed a memorandum addressing the duty to defend on 12 May 2005. Auto-Owners then filed a

response to Whitewood's memorandum on 1 June 2005, and the Potter defendants filed a reply brief on 3 June 2005.

On 19 August 2005, while the summary judgment motion was under consideration, this court ordered a settlement conference and appointed United States Magistrate Judge David Daniel as Settlement Master. The parties attended a settlement conference on 20 September 2005, and, as a result of the settlement negotiations, Auto-Owners and Whitewood entered into an agreement to settle the issues between them (hereinafter the 2005 Partial Settlement). On 11 October 2005, Auto-Owners and Whitewood filed a motion for an order of dismissal of all claims between Auto-Owners and Whitewood setting forth the terms of their agreement and noting the parties' inability to settle the claims with the Potter litigants. The Potter litigants filed a response on 13 October 2005. On 26 October 2005, Auto-Owners requested leave to file a supplemental brief in opposition to the Potter litigants' motion for summary judgment. The Potter litigants filed a response objecting to the filing of the supplemental brief on 2 November 2005, and Auto-Owners filed a reply on 14 November 2005. On 21 December 2005, this court allowed Auto-Owners' motion to file the supplemental brief and, at the same time, allowed the motions of the Potter litigants and Whitewood to file exhibits in response to that supplemental brief and a memorandum of law, respectively. The additional materials addressed the effect of the 2005 Partial Settlement reached between Whitewood and Auto-Owners on the issues remaining in the case.

The Effect of the 2005 Partial Settlement

The settlement conference ordered by this court did not result in a global settlement. Auto-Owners and Whitewood entered into a settlement agreement and release, a copy of which

they have provided to the court. Auto-Owners and the Potter litigants, however, could not reach a settlement. Auto-Owners maintains that the settlement it reached with Whitewood changes the nature of the issues before this court on summary judgment. Specifically, Auto-Owners claims that, because the only party to whom Auto-Owners could possibly have owed a duty to defend has settled its dispute with Auto-Owners, the duty to defend issue is moot. Auto-Owners contends that no court has yet affirmatively declared the existence of a duty to defend in this case and that this court is now incapable of doing so because the issue has effectively been withdrawn by Whitewood's settlement with Auto-Owners. Auto-Owners further maintains that any argument that Auto-Owners must pay the allegedly reasonable settlement entered into between Whitewood and the Potter litigants because of its unjustifiable failure to defend Whitewood is unavailing because of its dependency on the predicate finding of a duty to defend which is now moot. Auto-Owners in effect argues that the court must simply determine whether the settlement between Whitewood and the Potter litigants is enforceable against Auto-Owners and if so, whether there is coverage under the policy for the settled claims.

The Potter litigants, on the other hand, argue that Auto-Owners misused the mediation process in an attempt to resurrect its right to approve or disapprove the settlement of the underlying action between Whitewood and the Potter litigants. The Potter litigants continue to maintain that Auto-Owners' unjustified withdrawal of its defense of Whitewood during the course of the underlying proceedings forced Whitewood to settle that action by way of the 2003 Agreement, and that, by withdrawing unjustifiably, Auto-Owners waived its right to rely on the policy provisions precluding settlement without the authorization of the insurer. Moreover, the Potter litigants maintain that any provisions of the 2005 Partial Settlement purporting to release,

waive or impair any of Auto-Owners' indemnity obligations for the underlying 2003 Agreement are squarely inconsistent with the 2003 Agreement itself, pursuant to which Whitewood explicitly assigned to the Potter litigants all claims against Auto-Owners arising from the wrongful denial of coverage and withdrawal of defense, including any claim for indemnification of the settlement amount. According to the Potter litigants, the provision of the 2005 Partial Settlement noting that the 2005 Partial Settlement pertains only to the extent that it is "not inconsistent with the Settlement Agreement dated October, 28, 2003" means that the 2005 Partial Settlement has no bearing on the issues before the court in the pending summary judgment motion. (Potter Litigants' Resp. To Auto-Owners' Motion for Leave to File at 4-5.)

Having carefully considered all materials submitted on behalf of the parties in this action with respect to the effect of the 2005 Partial Settlement, the court must conclude that that agreement between Whitewood and Auto-Owners does not alter in any way the questions before this court as a result of the Potter litigants' motion for summary judgment. Auto-Owners' settlement with Whitewood does not moot the duty to defend issue as that issue is still a material part of a live controversy between the Potter litigants and Auto-Owners. Accordingly, the court will proceed to consider the issues presented by the summary judgment motion, whether Auto-Owners had a duty to defend Whitewood in the underlying proceedings, and if so, whether Auto-Owners' withdrawal of its defense of Whitewood in June 2003 was unjustifiable.[1]

[1] In its 25 April 2005 Order, this court set forth the manner in which it would address the Potter litigants' motion for summary judgment as follows: "First, the court will proceed to determine the duty to defend issues raised by the Fourth Circuit's remand of the case, and, if a duty to defend is found, the court will, in that same order, render a determination as to whether Auto-Owners unjustifiably withdrew its defense of Whitewood in the underlying state court action . . . ." (25 April 2005 Order at 4.)

Summary Judgment

Summary judgment is appropriate in those cases in which there is no genuine dispute as to a material fact, and in which it appears that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Haavistola v. Community Fire Co. of Rising Sun, Inc., 6 F.3d 211, 214 (4th Cir. 1993). Summary judgment should be granted in those cases "in which it is perfectly clear that no genuine issue of material fact remains unresolved and inquiry into the facts is unnecessary to clarify the application of the law." Id. In making this determination, the court draws all permissible inferences from the underlying facts in the light most favorable to the party opposing the motion. "[W]here the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, disposition by summary judgment is appropriate." Teamsters Joint Council No. 83 v. Centra, Inc., 947 F.2d 115, 119 (4th Cir. 1991).

Discussion

A. Duty to Defend

Whether or not Auto-Owners had a duty to defend Whitewood in the suit brought against it by the Potter litigants in state court is a question that the Fourth Circuit remanded to this court in its 27 July 2004 opinion. Auto-Owners Ins. Co. v. Potter, 105 Fed. Appx. 484, 498, 2004 WL 1662454 (4th Cir. July 27, 2004). Throughout this litigation, the Potter litigants have steadfastly maintained that Auto-Owners did have such a duty. Moreover, since June 2003, when Auto-Owners withdrew its defense of Whitewood in the underlying litigation based on this court's decision that coverage was barred by the pollution exclusion, the Potter litigants have consistently argued that such a withdrawal was unjustifiable and that it constituted a breach of the policy terms.

Because this court believes that the justifiable nature of the withdrawal in this case is dispositive of the issues before the court, the court will assume, for the sake of argument and for purposes of the pending motions, that Auto-Owners does owe Whitewood a duty to defend under the terms of the policy. In other words, the court will assume for purposes of this opinion, that, pursuant to the Fourth Circuit's remand order, the court cannot conclude that the exclusions offered by Auto-Owners completely bar coverage for all claims set forth by the Potter litigants.

B. Indemnification

Assuming the duty to defend, the court must determine whether Auto-Owners is obligated to indemnify Whitewood (in effect the Potter litigants by virtue of the 2003 Agreement) the amount specified in the 2003 Agreement between Whitewood and the Potter litigants.[2] The Potter litigants argue that Auto-Owners' obligation to pay them approximately six million dollars is premised on Auto-Owners' unjustifiable withdrawal of its defense of Whitewood in the midst of the underlying litigation. North Carolina cases consistently hold that "[w]hen an insurer without justification refuses to defend its insured, the insurer is estopped from denying coverage and is obligated to pay the amount of any reasonable settlement made in good faith by the insured of the action brought against him by the injured party." Ames v. Continental Casualty Co., 340 S.E.2d 479, 485 (N.C. Ct. App.) (citing Nixon v. Liberty Mutual Insurance Co., 120 S.E.2d 430 (N.C. 1961), and Maneikis v. St. Paul Ins. Co. of Illinois, 655 F.2d 818 (7th Cir. 1981)), rev. denied, 345 S.E.2d 385 (N.C. 1986). See also St. Paul Fire & Marine Ins. Co. v. Vigilant Ins. Co., 919 F.2d 235, 240 (4th Cir. 1990); Duke University v. St.

[2] The Fourth Circuit directed this court to determine which of the Potter litigants' claims Auto-Owners would ultimately be required to indemnify if the court determined that a duty to defend existed on remand. Because the parties in the underlying case entered into the 2003 Agreement settling all claims, however, such an exercise would be futile at this point.

Paul Fire and Marine Ins. Co., 386 S.E.2d 762, 763 (N.C. Ct. App.) ("defendant obligated itself to pay the amount and costs of a reasonable settlement if its refusal [to defend] was unjustified"; "[i]f the claim is within the coverage of the policy, the insurer's refusal to defend is unjustified even if it is based upon an honest but mistaken belief that the claim is not covered"), rev. denied, 393 S.E.2d 876 (N.C. 1990); Naddeo v. Allstate Ins. Co., 533 S.E.2d 501, 506-07 (N.C. Ct. App. 2000) ("Due to the 'possibility' that the claim would be covered by the policy, Allstate's refusal to defend was unjustified. When it unjustifiably refused to provide a defense, Allstate 'obligated itself to pay the amount and costs of a reasonable settlement.'" (citation omitted).)

Because this court finds, however, that Auto-Owners' withdrawal of its defense in June 2004 based on this court's judgment in its favor was not unjustifiable, the court must disagree with the Potter litigants' argument.

1. Facts Pertaining to Auto-Owners' Withdrawal of its Defense

Although it consistently denied liability, Auto-Owners defended Whitewood under a reservation of rights in the underlying proceedings beginning in the late Spring of 2001 and continuing through 1 June 2003. In October 2001, Auto-Owners instituted this action seeking a declaration of its rights and obligations under its policies with Whitewood. After receiving a judgment in its favor from this court and providing notice to Whitewood, (Auto-Owners' Verified Motion, Ex. C, 8 May 2003 Letter from Walter Brock to Kurt Olson), Auto-Owners withdrew its defense of its insured effective 1 June 2003, while this court's decision was on appeal to the Fourth Circuit and while claims were still pending against Whitewood in state

court.[3] Prior to withdrawing its defense, Auto-Owners notified Whitewood that it intended to do so and suggested that Whitewood seek a stay of the Order if it wished Auto-Owners to continue its defense of the insured. (Auto-Owners' Verified Motion, Ex. A, 15 April 2003 Letter from Steven Sartorio to Walter Brock[4] & Ex. C.)

Although Auto-Owners had formally withdrawn its defense of Whitewood, the insured and insurer engaged in ongoing written correspondence about Auto-Owners' decision to withdraw and a proposed settlement agreement between Whitewood and the Potter litigants. (Auto-Owners' Verified Mot., Ex. D, 23 June 2003 Letter from Kurt Olson to Walter Brock; Ex. E, 26 June 2003 Letter from Walter Brock to Kurt Olson; Ex. F, 14 October 2003 Letter from Kurt Olson to Walter Brock (forwarding proposed settlement agreement); & Ex. G, 17 October 2003 Letter from Walter Brock to Tyler Randolph.) In a letter dated 17 October 2003, Auto-Owners clearly indicated its disapproval of the proposed settlement agreement, characterized the proposed agreement as an attempt to dismiss Adams and effectively release Whitewood, suggested that such a course of action was improvident under the circumstances, and described an alternative settlement in which Auto-Owners would have been willing to participate, apparently despite its withdrawal of a defense. (Auto-Owners' Verified Mot., Ex. G.) Auto-Owners indicated that its view of a reasonable settlement was a maximum of $150,000 in accordance with

[3] According to Auto-Owners, the trial in the underlying case proceeded against the remaining defendants "with rulings by the trial court essentially stripping the plaintiffs of any meaningful claims for personal injury or property damage, and which trial resulted in a total defense verdict." (Auto-Owners' Verified Mot. at 11.)

[4] In this letter responding to Auto-Owners' suggestions, Mr. Sartorio stated that one of the reasons Whitewood may not seek a stay is because seeking a stay would cause a significant delay in getting Jim Adams individually out of the case. (Id.; Auto-Owners' Verified Motion, Ex. B, 24 April 2003 Letter from Steven Sartorio to Walter Brock.) While this may have been a valid consideration for Whitewood, it did not obviate the legal necessity of obtaining a stay to suspend Auto-Owners' right to rely on the court's 28 March 2003 Order in its favor.

the case evaluation report obtained by defense counsel for purposes of settlement negotiations and mediation. (Auto-Owners' Verified Motion, Ex. G & attachment.) The parties did not avail themselves of the opportunity to negotiate further with Auto-Owners. Auto-Owners clearly stated to Whitewood that its policies prohibited Whitewood from entering a settlement without Auto-Owners' participation and consent. Auto-Owners specifically conveyed to Whitewood its position that:

> It appears that you are trying to circumvent the judicial process when the ruling on your appeal will be forthcoming shortly. Auto-Owners remains prepared to abide by the ruling of the federal court, as it was when it asked the court to rule on its coverage obligations by filing the declaratory judgment action. However . . . you are risking a loss of all insurance coverage that would otherwise be in effect even if the appellants prevail on appeal. This only confirms to us that this is not a reasonable settlement or in good faith, and that your clients face no exposure regardless of the outcome of the appeal. If you proceed with the settlement, please be advised that Auto-Owners will have no choice but to add to its coverage defenses that all coverage has been lost by entering into an unapproved settlement which is neither a reasonable amount nor entered into in good faith.

(Auto-Owners' Verified Mot, Ex. G at 3.) Whitewood disregarded Auto-Owners' advice despite being warned explicitly of Auto-Owners' belief as to the consequences of Whitewood's actions under the policy. Thus, we are left with a settlement entered by Whitewood and the Potter litigants in the underlying action without Auto-Owners' consent.

2. Analysis of Auto-Owners' Withdrawal

Even assuming that there is a duty to defend under the terms of the policies, the recognition of such a duty at this point in the proceedings would not change the fact that Auto-Owners acted reasonably at the time it withdrew its defense of Whitewood in reliance on this court's March 28 Order that coverage was barred by the pollution exclusion. Auto-Owners' decision to discontinue its defense of Whitewood after requesting and receiving a declaratory

judgment stating that it had no duty to defend Whitewood cannot logically be considered an unjustified or unjustifiable refusal to defend, nor can it be considered a breach of contract relieving Whitewood from the policy provisions defining the duties and obligations of the insured.

The case law relied upon by the Potter litigants is not to the contrary. Those cases referenced by the Potter litigants in support of their argument that Auto-Owners bears responsibility for the settlement between Whitewood and the Potter litigants each involve situations in which insurers refused to defend their insureds at the outset or withdrew defenses mid-course. In support of treating those two situations similarly, at least one authority suggests that improperly withdrawing from a defense after undertaking it is no different than wrongfully refusing to defend in the first place:

> Where the insurer withdraws improperly from the defense of an action which it had already assumed, it breaches its duty to defend and it is in the position of an insurer which has refused to defend the action, and it is liable to the same extent as though it had initially wrongfully refused to defend the action. Accordingly, where a liability insurer wrongfully withdraws or abandons the defense of an action against an insured employer, there is authority that such withdrawal releases the insured from its obligation under a nonsettlement clause, thereby permitting the insured to enter into a compromise or settlement with the injured employee.

14 Couch on Insurance 3d §§ 200:56, 205:54 (2005).[5] Even in the context of that authority, however, the delineated consequences follow from an "improper" or "wrongful" withdrawal of a defense. While the Potter litigants are correct that North Carolina law suggests that the insurer will bear the delineated consequences of unjustifiable or improper withdrawal even if the decision

[5] It is not difficult to imagine a case in which an insurer would agree to defend an insured, and, at the same time undertake its own investigation of the matter at hand, ultimately withdrawing its defense when it concludes, on its own, that there is no coverage under the policy even though its insured is still in the midst of legal proceedings.

to withdraw was honestly made, the court must construe this rule and the case law applying it in a way that gives meaning or effect to the term "unjustifiable" and that also promotes the policy underlying the rule.[6] None of the cases cited by the Potter litigants involves a case in which an insurer has defended under a reservation of rights and simultaneously sought a declaration of its rights and obligations under the policy, withdrawing its defense only after receiving an order from a court justifying such conduct.[7]

In at least one case the North Carolina Court of Appeals has discussed the extent to which the duty to defend involves a substantial right to both the insured and the insurer.

[6] In Maneikis, the Seventh Circuit explained that:

> Under well-settled Illinois law, only three options are available to a liability insurer requested to defend an insured against claims which the insurer believes exceed policy coverage. The insurer can (1) seek a declaratory judgment regarding its obligations before or pending trial of the underlying action, (2) defend the insured under a reservation of rights, or (3) refuse either to defend or to seek a declaratory judgment at the insurer's peril that it might later be found to have breached its duty to defend. Once an insurer violates its duty to defend, it is estopped to deny policy coverage in a subsequent lawsuit by the insured or the insured's assignee.

Maneikis, 655 F.2d at 821. Here, Auto-Owners both defended the insured under a reservation of rights and sought a declaratory judgment as to the rights of the parties. The Seventh Circuit case, which North Carolina cited with approval in Ames, clearly suggests that the breach of contract, the unjustifiable nature of the withdrawal, and the consequent estoppel flow from a refusal to defend and refusal to seek declaratory judgment. Necessarily, the court must contemplate a different result when the insurer takes exactly the action that the case law and public policy suggest it should take.

[7] For example, in Ames, 340 S.E.2d at 482-83, Travelers filed suit against Continental's insured in January 1977, and the insured notified Continental of the suit and its duty to defend in September 1977. Continental refused to defend. Another insurer, Pullen, and the insured filed a declaratory action against Continental in June 1980. The underlying suit settled in September 1982, and Continental did not participate in any respect in the underlying litigation or the settlement of that case. In 1984, the trial court held in the declaratory judgment action that Continental owed the insured a duty to defend.

Also, in Lambe Realty, the insurer, Allstate, refused completely to defend the action brought against its insured in May 1997, and Allstate undertook the defense only after its insured filed a declaratory judgment against it and obtained a judgment to that effect. 527 S.E.2d at 331. Likewise, in Bruce-Terminix (Bruce), Zurich refused to defend Bruce at the outset of the suit filed against Bruce by plaintiff Gibson. Bruce initiated the declaratory judgment action to secure indemnification. 504 S.E.2d at 576-77. In Naddeo, Allstate refused to defend or provide an answer on behalf of its insured in the underlying action, and a default judgment was entered against its insured when the insured failed to participate in the proceedings. In subsequent proceedings, the court determined that Allstate did have a duty to defend and was thus barred from asserting its policy defenses. 533 S.E.2d at 506-07. See also Duke University, 386 S.E.2d at 763 (insurer denied coverage and refused to defend at outset of underlying proceedings; insured later brought declaratory judgment action to recover damages for the refusal to defend).

> The duty to defend is of great importance to both the insured and the insurer. If an insurer mistakenly refuses to defend its insured, the adverse consequences can be great. "When an indemnitor wrongfully refuses to defend an action against an indemnitee, the indemnitor is liable for the costs, including attorney fees and expenses, incurred by the indemnitee in defending the initial action and in vindicating its right to indemnity in a third-party action brought against the indemnitor." (Citation omitted.) On the other hand, if the insurer is required to defend an insured, " * * * [the insurer] may try an expensive negligence case which a court may later hold is not within the terms of the policy. * * * " (Citation omitted.)

Lambe Realty, 527 S.E.2d at 331. As is evident from the case law, every effort is made to construe a policy in favor of an insured, and the legal principles themselves ensure that if there is any possibility that any claim is covered the duty to defend applies. However, to hold that a withdrawal of a defense is improper even after a declaratory judgment has been obtained in favor of the insurer when a stay of the judgment has not been secured would seem to tip the balance too far in favor of the insured and to fail to give any credence to the substantial right of the insurer implicated by the duty to defend. Because the case law cited by the Potter litigants does not address this particular factual circumstance, the court will decline to characterize Auto-Owners' withdrawal in this case as improper or unjustifiable and to saddle Auto-Owners with the consequences that flow from a breach of contract.

Thus, this court cannot conclude that a withdrawal of a defense based on a decision of a federal court constitutes an "unjustifiable" withdrawal within the context of the North Carolina rule. This court had the ability to enter declaratory judgment pursuant to 28 U.S.C. § 2201(a), which provides that a court "may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought" and that "[a]ny such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such." The Order entered by this court awarding judgment to Auto-Owners

changes the equation, and the application of the cited legal principle regarding unjustifiable withdrawal, in two respects. First, the Order signifies that the insurer has taken the action that, as a matter of public policy, the rule encourages – giving the insured the benefit of the doubt and providing a defense while seeking a judicial declaration of rights. Second, the existence of a court order typically gives the prevailing party the right to rely on that order going forward absent a stay of the judgment. See Seven Words LLC v. Network Solutions, 260 F.3d 1089, 1099 (9th Cir. 2001) (citing "well-established rule that an appeal will not affect the validity of a judgment or order during the pendency of the appeal, absent a stay or supersedeas"); Guinness PLC v. Ward, 955 F.2d 875, 898 (4th Cir. 1992) ("[I]t is both the majority position among the federal courts and the position adopted by § 10-702 of the Maryland Uniform Recognition Act that the existence of a pending appeal does not render a judgment unenforceable nor suspend its preclusive effects absent a party obtaining a stay from either the rendering or enforcing court. Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction § 4433.").

Auto-Owners persuasively argues that the Potter litigants or Whitewood could have attempted to seek a stay of the judgment if either party expected Auto-Owners to continue defending Whitewood while the case was on appeal. See Brinn v. Tidewater Transportation Dist. Comm'n, 113 F.Supp.2d 935 (E.D. Va. 2000) (citing U.S. Ct. of App. 4th Cir. R. 8, which notes that the filing of a notice of appeal does not automatically stay the execution of the judgment, order, or decision for which review is sought, and In re Federal Facilities Realty Trust, 227 F.2d 651, 654 (7th Cir. 1955) (judgment can be executed while appeal pending and stay only becomes effective upon posting of court-approved bond)), aff'd, 242 F.3d 227 (4th Cir. 2001).

With respect to the stay issue, the Potter litigants claim that Federal Rule of Civil

Procedure 62 was not applicable because courts have limited the application of Rule 62(d) to stays of judgments for money and the declaratory judgment at issue here did not require any party to pay money. The court notes that the judgment in Auto-Owners' favor certainly had a monetary dimension, however, in that Auto-Owners' continued representation of Whitewood in the underlying proceedings would have continued to cost Auto-Owners money for the duration of the underlying proceedings. Auto-Owners' decision not to continue spending that money after obtaining a judgment in its favor was not unreasonable. On the flip side, this court's judgment in Auto-Owners' favor had a monetary dimension for Whitewood, because the judgment required Whitewood to pay its own defense costs in the underlying action. See Arnold v. Garlock, Inc., 278 F.3d 426 (5th Cir. 2001) ("The stay provisions of Rule 62 pertain to judgments for money. . . . That does not preclude diverse forms of judgment pertaining to monetary responsibility from a stay under Rule 62(d) pending appeal . . . . See id. at 938-39 (overturning a district court's denial of a stay of declaratory judgment where the declaratory judgment was, in effect, a money judgment suitable for a Rule 62(d) stay subject to the requirements of Rule 62(a))."); Hebert v. Exxon Corp., 953 F.2d 936, 938 (5th Cir. 1992) ("The applicability of Rule 62(d) turns not on [the] distinction [between declaratory and money judgments], but on whether the judgment involved is monetary or nonmonetary, so long as the judgment is not otherwise excepted under Rule 62(a)."). Because the declaratory judgment here relieved Auto-Owners of the obligation to continue to spend money on Whitewood's behalf, and imposed that obligation on Whitewood, the judgment was monetary in nature, and the posting of a bond would have protected Auto-Owners' rights in the event the decision was affirmed on appeal. See Poplar Grove Planting and Refining Co., Inc. v. Bache Halsey Stuart, Inc., 600 F.2d 1189, 1190 (5th Cir.1979) ("[T]he purpose of a

supersedeas bond is to preserve the status quo while protecting the non-appealing party's rights pending appeal."). Thus, Rule 62 could have been applicable, and Whitewood could have argued its entitlement to a stay pursuant to that rule.

In any event, even if Whitewood and the Potter litigants were not entitled to a stay if they posted a bond under Rule 62, or if the parties could not afford to post the bond necessary to invoke Rule 62, they nevertheless could have applied to the court for a stay.

> [A] district court's inherent discretionary power to stay judgments pending appeal on the basis of less than a full supersedeas bond, or no bond, is not addressed or affected by Rule 62(d), which establishes only the narrow proposition that a full supersedeas bond *entitles* an appellant to the issuance of a stay pending disposition of the appeal. Left to be resolved is . . . what principle guides a district court's exercise of discretion to issue a stay of the judgment on less than a full bond securing the entire judgment. Alexander, 190 F.R.D. at 192; see also Kirby v. Gen. Elec. Co., 210 F.R.D. 180, 195 (W.D.N.C. 2000) ("Rule 62(d), while addressing when a party is entitled to a stay as a matter of right, does not address when a court, in its discretion, may stay a judgment pending appeal on terms other than a full supersedeas bond.").

Southeast Booksellers Ass'n v. McMaster, No. CIV.A. 2:02-3747-23, ___ F.Supp.2d ___, 2006 WL 20423 (D.S.C. Jan. 4, 2006). Had either party requested that the court exercise its discretion to stay the judgment, this court could have reviewed that request in accordance with Fourth Circuit law, which requires "a party seeking a stay [to] show (1) that he will likely prevail on the merits of the appeal, (2) that he will suffer irreparable injury if the stay is denied, (3) that other parties will not be substantially harmed by the stay, and (4) that the public interest will be served by granting the stay." Long v. Robinson, 432 F.2d 977, 979 (4th Cir. 1970), aff'd, 436 F.2d 1116 (4th Cir. 1971). The court will not attempt to set forth what action it may have taken if confronted with a request for a stay.[8] The court merely sets forth the applicable law regarding the effect of

[8] As Auto-Owners notes, it appears that the Potter litigants could also have sought a stay of the state court (continued...)

final judgments, and the possibility of and rationale behind stays to support its conclusion that Auto-Owners' decision to withdraw cannot be considered unjustifiable under the circumstances.

3. Consequences of Justifiable Withdrawal

Having found that the withdrawal of defense was justifiable, the court cannot turn around and characterize that withdrawal as a breach of contract. The Potter litigants have argued that because Auto-Owners breached the policies by withdrawing, Auto-Owners is estopped from relying on the provisions in the policies that prohibit the insured from settling without the insurer's consent. The policies at issue contain "no action" clauses which provide that no person may sue Auto-Owners except on an agreed settlement or on a final judgment entered after a trial: "An agreed settlement means a settlement and release of liability signed by us, the insured and the claimant or the claimant's legal representative." (Potter litigants' Ex. 2-4 (policy pages 50, 51 and 54 respectively).) The contracts also state that "[n]o insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without our consent." (Potter litigants' Ex. 2-4 (policy pages 49, 50 and 53 respectively).) Under these provisions, Auto-Owners is not liable for the unauthorized and disapproved settlement entered by Whitewood. See Terrell v. Lawyers Mutual Liability Ins. Co., 507 S.E.2d 923 (N.C. Ct. App. 1998) (where the policy at issue provided that "[n]o action shall lie against the Company . . . until the amount of the Insured's obligation to pay shall have been finally determined either by final judgment against the Insured after actual trial or by written agreement

[8](...continued)
proceedings during the pendency of the appeal of the declaratory judgment in Auto-Owners' favor. A stay of the underlying proceedings would have had the effect of alleviating the defense costs that Whitewood would have to pay in the interim between this court's judgment and the Fourth Circuit's decision on appeal. The Potter litigants have not indicated to the court why a stay of those proceedings was inadvisable or impossible.

of the Insured, the claimant and the Company," a memorandum of settlement between the plaintiff in the underlying case and the insured in which the insured agreed to sign a confession of judgment was not binding on the insurer because the insurer was not a party to the settlement). Because its withdrawal of its defense was justifiable given this court's Order in its favor, its withdrawal did not constitute a breach of its contract, and Auto-Owners is not estopped from relying on the explicit provisions in its policies precluding its insured from entering unauthorized settlements. As previously recognized, the insured, Whitewood, entered a settlement with the Potter litigants without Auto-Owners' consent. Having entered an unauthorized settlement agreement, the Potter litigants, as Whitewood's assignees, are precluded from relying on that agreement as a basis for indemnification by Auto-Owners.

Conclusion

Because its withdrawal was justifiably premised on this court's Order in its favor, and because its withdrawal in those circumstances did not constitute a breach of its contract, Auto-Owners is not estopped from relying on the policy provisions protecting it from responsibility for a settlement to which it was not a party and to which it did not consent. The Potter litigants' motion for summary judgment is therefore DENIED. Auto-Owners' and Whitewood's motion to dismiss is ALLOWED. As all issues between the parties are resolved by this Order, the case is

DISMISSED.

This 7 February 2006.

W. Earl Britt
Senior U.S. District Judge

aoi/pd/jcd

TRAVELERS v. INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

TRAVELERS CASUALTY & SURETY COMPANY, formerly known as THE AETNA CASUALTY AND SURETY COMPANY,

Plaintiff,

v.

INSURANCE COMPANY OF THE STATE OF PENNSYLVANIA, NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, and DOES 1 through 10,

Defendants.
/

No. C 04-03875 WHA

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

In this dispute between insurance carriers, defendants Insurance Company of the State of Pennsylvania ("ISOP") and National Union Fire Insurance Company of Pittsburgh, PA move for summary judgment as to plaintiff Travelers Casualty & Surety Company's third claim for relief for equitable contribution. For the reasons stated herein, defendants' motion is **GRANTED IN PART**.

STATEMENT

This dispute revolves around a previous settlement in a construction lawsuit in San Francisco Superior Court, entitled *Board of Trustees of the California State University v. Perini*

Building Company, et. al., Case No. 304093. That state-court action centered around Perini's liability for damage from leaks after construction work by Perini. The parties to the above-captioned action are insurers that together contributed $16.25 million to that settlement, with Travelers paying $12 million and National Union paying $4.25 million.

The following insurance policies are implicated by this dispute. Travelers issued Perini six commercial-general-liability policies each with two million dollar limits per occurrence (Compl. at ¶ 7, Br. 13). Travelers also issued Perini a commercial-excess-liability policy for Perini with a limit of ten million dollars per occurrence (*id.* at ¶ 8). ISOP issued four commercial-general-liability policies to Perini each with limits of two million dollars (*id.* at ¶¶ 9–12). Finally, National Union issued Perini two commercial-umbrella policies with aggregate limits of $50 million and one commercial-umbrella policy with an aggregate limit of $25 million (*id.* at ¶¶ 13–15).

In short, plaintiff contends that it paid a disproportionate share. On September 15, 2004, plaintiff filed its complaint. Plaintiff's third claim for relief alleges a claim for equitable contribution related to payment of the settlement, seeking indemnity from ISOP and National Union under their respective policies. Defendants now move for summary judgment on this claim.

ANALYSIS

1. LEGAL STANDARD FOR SUMMARY JUDGMENT.

Pursuant to FRCP 56(c), summary judgment shall be rendered if "there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." On a motion by a party without the burden of proof at trial:

> The moving party may produce evidence negating an essential element of the nonmoving party's case, or, after suitable discovery, the moving party may show that the nonmoving party does not have enough evidence of an essential element of its claim or defense to carry its ultimate burden of persuasion at trial.

Nissan Fire & Marine Ins. Co., Ltd. v. Fritz Companies, Inc., 210 F.3d 1099, 1106 (9th Cir. 2000).

2. EQUITABLE CONTRIBUTION.

Plaintiff's claim for equitable contribution is governed by California law. In the context of insurance law:

> Equitable contribution permits reimbursement to the insurer that paid on the loss for the excess it paid over its proportionate share of the obligation, on the theory that the debt it paid was equally and concurrently owed by the other insurers and should be shared by them pro rata in proportion to their respective coverage of the risk.

Am. Cont'l Ins. Co. v. Am. Cas. Co., 86 Cal. App. 4th 929, 937 (2001)(internal citation omitted). "Every California case of which we are aware has enforced an insurer's contribution claim only where the other insurer was also obligated to pay on the claim." *Ibid.*

"Under well-settled insurance principles, there are two levels of insurance coverage, primary and excess." *Reliance Nat'l Indem. Co. v. Gen. Star Indem. Co.*, 72 Cal. App. 4th 1063, 1076 (1999)(citation omitted). No right to contribution exists between insurers at the different risk levels. *Id.* at 1077–78.

This rule barring cross-risk-level contribution eliminates certain portions of plaintiff's third claim as a matter of law. National Union only provided *excess* insurance to Perini. Travelers cannot seek equitable contribution for the two million dollar payment pursuant to its *primary* coverage from National Union's *excess* policies. Likewise, this rule bars contribution for payments made under Travelers' *excess* policies from ISOP's *primary* policies. The only theoretically sustainable claims are for contribution for Travelers' *primary* payments from ISOP's *primary* policies and for Travelers' *excess* payments from National Union's *excess* policies.

Furthermore, "[i]t is settled under California law that an excess or secondary policy does not cover a loss, nor does any duty to defend the insured arise, until all of the primary insurance has been exhausted." *Cmty. Redev. Agency v. Aetna Cas. & Sur. Co.*, 50 Cal. App. 4th 329, 339 (1996)(citation omitted). Before the National Union excess policies would even be implicated, therefore, all six of Travelers' primary policies would have to be exhausted. Each of those

policies had limits of two million dollars with respect to Perini. Beyond that, all four of the ISOP primary policies would have to be exhausted. Given that only $12 million is at stake, there is no possibility that the primary policies would be exhausted such that National Union would be required to contribute on the basis of its excess policies. At oral argument, plaintiff's counsel admitted that she had no authority countering this conclusion. Instead, plaintiff's counsel asserted, without citation, that the Court could ignore the rule of exhaustion by applying "the rule of equity." Absent any proof that equity requires such a departure from the rule of exhaustion here, however, this order finds that National Union is not responsible to plaintiff for contribution.

In an attempt to salvage its complaint, plaintiff argues that this Court should read into the complaint a claim for subrogation, relying on the liberal doctrine of notice pleading under FRCP 8. It is not true, however, that by alleging equitable contribution a defendant is automatically on notice of a claim for subrogation—a claim for "[e]quitable contribution is entirely different" from a claim for subrogation. *Fireman's Fund Ins. Co. v. Md. Cas. Co.*, 65 Cal. App. 4th 1279, 1292 (1998). In any event, "[a]n opposition is not the proper forum to raise new claims." *Smith v. Coleman*, No. C 01-20576, 2001 WL 1220736, *2 n. 1 (N.D. Cal. Sep. 27, 2001).

* * *

The only remaining portion of plaintiff's claim is for contribution on the two million dollars paid under Travelers' *primary* policies against ISOP's *primary* policies. As to this claim, defendants argue that Travelers failed to bring forth sufficient evidence during discovery to indicate a possibility of success at trial. This order disagrees.

The primary flaw with defendants' argument is a mistake about defendants' own interrogatory questions. Defendants argue at length that plaintiff's interrogatory responses demonstrate a lack of evidence to prove at trial that an obligation by Travelers to indemnify Perini ever arose with respect to the leak damage. In the definition section for defendants' interrogatories, defendants defined "THE PERINI ACTION" as a separate action between Perini and Travelers (Fredette Decl. Exh. A). All of the allegedly deficient responses were to

questions aimed at that action. The underlying action at hand here, *Board of Trustees of the California State University v. Perini Building Company, et. al.*, was named "THE TRUSTEES ACTION" by defendants for purposes of the interrogatories (*ibid.*). Defendants simply did not frame any interrogatories to plaintiff to discover information about Travelers' obligations stemming from the "THE TRUSTEES ACTION."

On reply and at oral argument, defendants' counsel tried to wish away this argument about the interrogatories by contending both that THE PERINI ACTION was equally relevant to the above-captioned matter and that, in any event, plaintiff provided generally elusive and technical discovery responses which indicate an absence of proof. As to the first point, THE PERINI ACTION is *not* equally relevant to the issue of whether the leak damages for which Perini was liable onset Travlers' obligation of indemnification for the THE TRUSTEES ACTION. As plaintiff's counsel explained at oral argument, THE PERINI ACTION ultimately boiled down to a dispute between Perini and Travelers over legal fees, not over indemnification rights. ISOP's second contention about elusive interrogatory answers should have been raised, if at all, in the context of a discovery motion, not on a motion for summary judgment.

Defendants' remaining argument is an attack on Travelers' initial disclosures of witnesses and documents. Defendants contend that the disclosures indicate an inability of plaintiff to prove at trial that an obligation to insure arose. Travelers, however, did indicate an extensive list of individuals plausibly able to testify to the obligation issue, including Perini personnel, Travellers' personnel and counsel from the underlying action. Likewise, Travelers pointed to numerous sets of documents available to prosecute this action, including the documents from the underlying action. These disclosures were not so inadequate as to warrant summary judgment. A material issue of fact exists whether Travelers bore an obligation to indemnify Perini for the leak damage and, if so, whether ISOP's *primary* policies should provide contribution toward the two million dollar payment made from Travelers' *primary* policies.

CONCLUSION

For the foregoing reasons, defendants' motion for summary judgment on plaintiff's third claim for relief is **GRANTED IN PART**. Plaintiff's third claim is still viable as to ISOP's primary policies for possible contribution toward payment made by Travelers under Travelers' primary policies. This order declines to rule on defendants' request for judicial notice as the documents defendants seek to notice were not relevant to the disposition. Likewise, this order does not rely on any of the evidence objected to by defendants, thus no ruling is necessary. Trial is set for March 6, 2006 and will proceed as scheduled.

IT IS SO ORDERED.

Dated: January 19, 2006

WILLIAM ALSUP
UNITED STATES DISTRICT JUDGE

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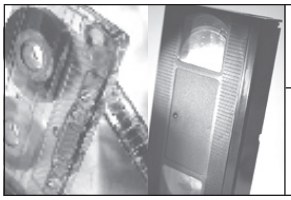

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