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# Construction & Infrastructure Law Blog

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## The Year 2010 In Review: Construction Insurance Issues

*This article is the seventh in a series summarizing construction law developments for 2010.*

*By Candace Matson, Harold Hamersmith & Helen Lauderdale*

1. Forecast Homes, Inc. v. Steadfast Insurance Co., 181 Cal. App. 4th 1466 (4th Dist. Jan. 2010), *rev. denied*, 2010 Cal. LEXIS 4356

A home developer, acting as a general contractor, hired subcontractors to build homes. The subcontracts all required the subcontractors to defend and hold the developer harmless against any liability arising out of their work and to add the developer to their commercial general liability policies as an additional insured. A construction defect litigation was brought against the developer, but not against the subcontractors. The developer tendered its defense to Steadfast Insurance Company, which insured many of the subcontractors and on whose policies the developer was an additional insured. The insurer refused the tender, maintaining that only the named insured subcontractors could satisfy the per occurrence self-insured retention ("SIR") amounts and none of the subcontractors had done so because they did not incur defense or indemnity costs in the litigation.

In a bench trial, the court concluded that the policies unambiguously allowed only the named insured, and not the developer, to satisfy the SIR obligation. The Court of Appeal affirmed, agreeing that the policy language of "you" and "your" means the named insured when read together with the provision that "you shall be responsible for payment of all damages and defense costs for each occurrence or offense until you have paid self-insured retention amounts and defense costs equal to the per occurrence amount shown in the endorsement." The words "or any insured" in the definition of the SIR, did not create ambiguity as to who may pay the SIR; rather it was intended to define what amounts and expenses qualify for the named insured's SIR payment. As to the public policy argument raised by the developer, the Court stressed that the subcontractors, not the developer, formed the insurance contracts and that the subcontractors may have wanted to control the exhaustion of the SIR. Further, the policy's restriction on who may pay the SIR did not render the developer's coverage illusory. In conclusion, it is not against public policy for a commercial general liability

policy to provide that the additional insured may not pay the SIR in order to trigger coverage.

2. Interstate Fire and Casualty Insurance Co. v. Cleveland Wrecking Co., 182 Cal. App. 4th 23 (1st Dist. Feb. 2010)

A general contractor entered into subcontracts with Delta and Cleveland, pursuant to which each subcontractor agreed (i) to indemnify the general contractor for liability arising out of its work and to (ii) procure general liability insurance to which the general contractor would be an additional insured. Only Delta complied with the latter obligation, obtaining a commercial general liability policy from Interstate Fire and Casualty Insurance Company. During the performance of work, one of Delta's employees was injured by falling debris dislodged by Cleveland's operations. The employee filed suit against Delta, Cleveland and the general contractor. The general contractor tendered defense of the lawsuit to both subcontractors and to Interstate. Cleveland rejected the tender, but Interstate, pursuant to the Interstate-Delta policy, accepted it. The general contractor settled with the Delta employee and Interstate paid the settlement and attorney's fees. Cleveland also entered into a settlement with the Delta employee and obtained a good faith settlement determination.

Interstate filed a suit for subrogation against Cleveland for breach of contract in failing to defend and indemnify the general contractor. Cleveland demurred, contending that the good faith settlement cut off the general contractor's ability to sue for indemnity or contribution. The trial court sustained the demurrer, observing that the general contractor sustained no damages as a result of the breach and so had no claim.

The Court of Appeal reversed. The Court held that Interstate, standing in the shoes of an insured, could pursue a cause of action against Cleveland for breach of express contractual indemnification clause notwithstanding a good faith settlement determination. Another issue raised in the demurrer was the comparative equitable position of Cleveland and Interstate. The Court noted, that as an element of subrogation, Interstate must be in an equitable position superior to Cleveland in order to obtain subrogation. Addressing that issue, the Court found that Interstate and Delta had fulfilled their contractual obligations, whereas Cleveland had not. Accordingly, Interstate was in a superior equitable position as compared to Cleveland. Because the insurer was in a superior equitable position it stated a cause of action against Cleveland.

3. PMA Capital Insurance Co. v. American Safety Indemnity Co., 695 F. Supp. 2d 1124 (E.D. Cal. March 2010)

PMA Capital Insurance Company sued coinsurer American Safety Indemnity Company ("ASIC") for equitable contribution on the grounds that the coinsurer had a concurrent duty to defend a mutual insured in an underlying construction defect case. The parties cross- moved for summary judgment. The primary issue in the case was the definition of the term "occurrence" in the liability policy issued by the coinsurer. The District Court held that the term "occurrence" included only negligent work done by the insured that

caused property damage. PMA could not establish that the occurrence, i.e., the insured's negligent work, occurred during the ASIC policy periods. Without negligent work by the insured during the policy period, PMA did not meet the burden of demonstrating potential for coverage under the ASIC policy. Accordingly, the District Court granted ASIC's motion for summary judgment.

4. Scottsdale Insurance Co. v. Century Surety Co., 182 Cal. App. 4th 1023 (2d Dist. March 2010)

Two insurers shared multiple construction subcontractors as mutual insureds. Frequently, Century Surety Co. would decline to participate in the defense and indemnity of the mutual insureds. Scottsdale Insurance Co. filed suit seeking equitable contribution with respect to over 300 underlying actions involving the mutual insureds. In allocating responsibility between the insurers, the trial court applied the following standard: "where someone's wrong has made it difficult to provide exact numbers as to loss or damage, plaintiff does not bear the burden of exactitude." The trial court concluded that Scottsdale could recover one-half of the amounts it paid on approximately 80 underlying claims.

On appeal, the Court held that when multiple insurance companies have a duty to defend a mutual insured in a legal action and one declines to participate in the defense, an insurer seeking equitable contribution from the non-participating insurer must prove that it paid more than its "fair share" of the defense and indemnity costs for the common insured. The insurer seeking equitable contribution also bears the burden of producing the evidence necessary to calculate a "fair share." One insurer cannot recover equitable contribution from another insurer for any amount that would result in the first insurer paying less than its "fair share" even if that means that the otherwise liable second insurer will have paid nothing. Because the trial court applied an incorrect standard, the Court of Appeal reversed and remanded the case for an allocation determination.

5. Pennsylvania General Insurance Co. v. American Safety Indemnity Co., 185 Cal. App. 4th 1515 (4th Dist. June 2010), *rev. denied*, 2010 Cal. App. LEXIS 11011

A framing subcontractor was insured by Pennsylvania General Insurance Company under a commercial general liability policy while performing work on an apartment construction project ("Project"). At the conclusion of the policy period, and after the subcontractor's work was completed, the subcontractor was issued a new commercial general liability policy by American Safety Indemnity Company ("ASIC"). The subcontractor was then sued in a construction defect suit involving the Project. The subcontractor tendered its defense to both Pennsylvania General and ASIC. Pennsylvania General accepted the tender of the defense and paid the subcontractor's defense and settlement costs. ASIC denied the subcontractor's tender and did not participate in defending or indemnifying the subcontractor, claiming that the allegedly defective work did not occur during the ASIC policy period. Pennsylvania General sued ASIC for equitable contribution for a portion of the defense and indemnity costs. The key issue was whether the trigger for coverage occurred within the ASIC policy period.

The trial court concluded it did not and entered summary judgment for ASIC.

The Court of Appeal reversed. The Court noted that when construing insurance policies, ambiguities in coverage clauses must be resolved broadly in favor of coverage. The Court held that ASIC's policy, read as a whole, was reasonably susceptible to the interpretation that resulting damage, and not causal conduct, was a defining characteristic of the "occurrence" that must take place during the policy period to trigger coverage. Accordingly, it was error to grant summary judgment in ASIC's favor.

6. Clarendon America Insurance Co. v. North American Capacity Insurance Co., 186 Cal. App. 4th 556 (4th Dist. June 2010), *reh'g denied*, 2010 Cal. LEXIS 9459

A homebuilder was insured by two insurance companies, Clarendon America Insurance Company and North American Capacity Insurance Company ("NAC"). Clarendon sued NAC seeking proportionate or equitable share of sums Clarendon expended to defend the homebuilder in a construction defect class action. NAC moved for summary judgment on the ground that its duty to defend the homebuilder never materialized as the homebuilder never paid a $25,000 "per claim" self-insured retention for *each* of the homes involved in the class action completed *after* the effective date of the NAC policy. The trial court granted NAC's motion. The Court of Appeal reversed because, in light of other terms of the NAC policy and the circumstances surrounding the issuance of the policy, the homebuilder may have had an objectively reasonable expectation that the self-insured retention would apply to the class action as a whole rather than to each of the homes constructed after the policy was issued. NAC failed to show the homebuilder had no reasonable expectation of coverage or defense as a matter of law.

7. Clarendon America Insurance Co. v. StarNet Ins. Co., 186 Cal. App. 4th 1397 (4th Dist. Oct. 2010), *rev. granted*, 2010 LEXIS 11395

The developer of a residential housing development was served by the homeowners association with a Calderon Notice commencing an alternative dispute process which was a prerequisite to filing a complaint for construction defects. The developer sued Clarendon seeking payment of defense costs incurred in defending against the Calderon Notice. Clarendon, in turn, sued StarNet (the developer was an additional insured on both insurer's policies). StarNet argued that the Calderon ADR proceedings did not consitute a "suit" within the meaning of its policy. The trial court disagreed and the appellate court affirmed. The latter applied the "literal meaning" approach (as opposed to the "functional equivalent" approach) to determine what constitutes a proceeding which triggers the defense obligation, as mandated by the California supreme court in Foster-Gardner, Inc. v. National Union Fire Ins. Co., 18 Cal. 4th 857 (1998). The court found that the Calderon Notice and ADR process is mandatory and "one part - the first step – in a continuous litigation process." Therefore, it met the definition of "suit" in the StarNet policy. [This case was granted review, but further action was deferred pending consideration of the Ameron case discussed below.]

8. Arrowood Indemnity Company v. Travelers Indemnity Company of Connecticut, 188 Cal. App. 4th 1452 (2d Dist. Oct. 2010)

A general contractor held two CGL policies for different periods. The contractor was sued for negligence allegedly committed during the second policy period and the second insurer provided both defense and indemnity. The jury found the contractor was negligent, but it was not clear from the verdict whether it found the negligence to have occurred during the first policy period, the second policy period or both. The second insurer sued the first insurer for equitable contribution. The appellate court characterized this as a case of first impression: where one insurance has participated in the defense and/or indemnity of an insured and the other has not, which bears the burden of proving the existence or nonexistence of coverage? The court held that under such circumstances, the participating insurer meets its burden of proof when it makes a showing of coverage under the other insurer's policy. The burden then shifts to the nonparticipating insurer to prove that, in fact, there is no coverage.

9. Ameron International Corp. v. Insurance Co. of the State of Penn., 50 Cal. 4th 1370 (Nov. 2010)

The insured was a subcontractor who manufactured and installed concrete siphons for an aqueduct project being performed for the US Dept. of the Interior Bureau of Reclamation. Long after the siphons were installed, they were discovered to be defective, and the Bureau's contracting officer ("CO") sought to recover $40M from the subcontractor for the continuous and progressive deterioration of the materials. Under the Contract Disputes Act of 1978, the insured subcontractor had the option to challenge the CO's decision either by appealing the decision to the US Department of Interior Board of Contract Appeals ("IBCA") or by bringing an action in the US Court of Federal Claims. The insured chose the former forum, and following 22 days of "trial," settled the CO's claim for $10M. The insured sought to recover the settlement and its defense costs from its liability insurers. The trial court ruled as a matter of law that none of the policies provided coverage, and the appellate court affirmed since the policies only obligated defense of "any suit . . . seeking damages" and indemnity for "all sums which the insured is legally obligated to pay as damages," but did not define either "suit" or "damages." The courts applied the bright-line holding of Foster-Gardner, Inc. v. National Union Fire Ins. Co., 18 Cal. 4th 857 (1998) in which the court applied the "literal meaning" of the word "suit" to mean an action filed in a court of law. The California Supreme Court reversed, stating that its holding in Foster-Gardner, which concerned an administrative action designed to obtain a negotiated settlement of the insured's liability for environmental pollution, was based on its concern that the order did not provide insurance companies with sufficient notice of the parameters of the action against the insured. In this instance, however, the Supreme Court found that the adjudicative IBCA proceeding did not raise the same concern in that a complaint filed in the IBCA gave "as much, if not more, notice to insurers" as would a complaint filed in court, and noting the similarities between a court and an IBCA proceeding (the latter being authorized to conduct trials, determine liability and award damages). This opinion is thus an expansion of an insurer's obligation deriving from similar policy language to

defend and indemnify its insured who participates in an adjudicative administrative proceeding.

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