Smith Freed Eberhard

CONSTRUCTION CASE UPDATE

Oregon and Washington

case in point ...

Insurance coverage cases with "Okay" and "Awful" results

From the Desk of Jack Levy: It's been a busy spring in the Northwest courts. Oregon continues to strictly construe policy language against insurers, yet still within the framework of established coverage analysis. At the same time, Washington coverage law just got exponentially worse. This update contrasts the current outlook of these courts so that you can better understand where things are heading.

Claims Pointer: In this mixed bag of decisions:
1) The Oregon Court of Appeals rejected the argument that a default judgment is presumptively covered by liability insurance and affirms the insurer's right to a jury trial on coverage exclusions. The court holds that there is coverage for attorneys' fees under the policy and that a multi-unit residential building exclusion does not apply to mixed use projects.

2) The Washington Supreme Court up-ends the analytical framework of liability insurance coverage by applying the property insurance concept of "efficient proximate cause" to avoid the application of a pollution exclusion. This is really a big deal for construction defect and environmental litigation and has potential spill over into many other areas.

1) Oregon Court of Appeals: Hunters Ridge Condominium Association v. Sherwood Crossing, LLC, 285 Or.App. 416 (5/11/17).

In this case, the Oregon Court of Appeals essentially rejects the plaintiff's argument that coverage should be expanded to cover the whole judgment against a subcontractor because some of the award involved property damages. It involved American Family Insurance which insured a siding subcontractor who was sued by both the developer and the general contractor in a construction defect lawsuit involving a mixed use (residential and commercial) condominium project. American Family declined the subcontractor's defense as the policy contained a multi-unit residential building exclusion. Default judgments were taken against the subcontractor. The plaintiff homeowners association (HOA) then settled the claims against the developer and the general contractor; the settlements included assignments to the HOA of the default judgments against the subcontractor. The HOA then brought a garnishment proceeding against American Family to collect the coverage available under the subcontractor's policy. The court made several important rulings:

•The "Multi-Unit Residential Building" exclusion does not apply to a mixed use condominium project which includes both residential and commercial units. American Family incorrectly declined the subcontractor's defense based on this exclusion. There were no bad faith consequences; rather, American Family just made a bad call. The term "Multi-Unit Residential Building" was defined to mean "a condominium, townhouse, apartment or similar structure, each of which has greater than eight units built or used for the purpose of residential occupancy." The court held that the term was ambiguous, and therefore inapplicable to siding work on a mixed use building, because the ordinary purchaser of insurance would not interpret the exclusion to apply to work performed on a mixed-use building. The exclusion—by its terms, title and in context—applies to multi-unit residential buildings, which could reasonably be understood to mean buildings used exclusively for residential purposes;

•An Insurer may develop facts in a garnishment proceeding to support the application of exclusions. American Family was allowed to develop the facts affecting coverage in the garnishment proceeding, particularly regarding whether the policy's "your work" exclusion applied to exclude coverage for the defectively installed siding. The settlement agreement did not include an itemized accounting of the specific types of repairs for which the settling parties were responsible, therefore, the HOA did not establish whether the amounts paid were for covered property damage or uncovered corrections to defects in the subcontractor's work. Critically, the court disagreed with the HOA's argument that the default judgments – "without further inquiry" – presumptively establish that American Family is liable for the settlement amounts "because of"

Contact: Jack Levy | www.smithfreed.com | email: jlevy@smithfreed.com
Ph: 503.227.2424 | Fax: 503.227.2535 | 111 SW 5th Ave, Suite 4300 | Portland | OR | 97204

SMITH | FREED EBERHARD

case in point ...

Insurance coverage cases with "Okay" and "Awful" results

covered "property damage." The HOA's argument, in essence, was that the court should give the causal language "because of" in the liability insuring agreement the broadest interpretation possible: in other words, all of the judgment amounts should be paid because some of the harm caused by the subcontractor involved covered "property damages". In rejecting the HOA's argument, the court held that although the default judgments conclusively establish the extent of the subcontractor's liability, they do not establish that American Family is liable for the entire amount of the judgments;

•The Insurer has a constitutional right to a jury trial. Under the Oregon Constitution, and despite the language of the garnishment statute, American Family was entitled to a jury trial to resolve the factual disputes involved in the garnishment proceeding; and

•Attorneys' Fees are covered by the policy. Attorneys' fees constitute "damages" within the meaning of the policy because case law treats attorneys' fees incurred in defending against the HOA's lawsuit as a consequential damage arising out of the subcontractor's breach of the siding subcontract. The court also held that attorneys' fees are recoverable because they are considered "costs taxed against the insured" within the meaning of the policy's "Supplementary Payments" provision. It said that within the context of the policy as a whole, the phrase "costs taxed" is similar to the phrase "taxable cost," which, under the Black's Law Dictionary definition, refers to a "litigation-related expense that the prevailing party is entitled to as part of the court's award." The court held that this definition supports a construction of "costs taxed" as including "any litigation-related expenses awarded to a prevailing party, with no exception for attorney fees."

In short, there are good and bad points to be drawn from the Hunters Ridge opinion; nonetheless, it was decided along the established structure for interpreting liability insurance coverage. It's the devil you know.

2) Washington Supreme Court: Xia v. ProBuilders Specialty Ins. Co., --- P.3d ---- (4/27/17).

In this case, the Washington Supreme Court upsets the apple cart by creating a new framework for liability coverage analysis. A homeowner sued her contractor for personal injuries arising out of the release of carbon monoxide, which entered into her home because of an improperly installed water heater vent. The contractor's insurer, ProBuilders declined the contractor's defense, citing the absolute pollution exclusion in its policy. The pollution exclusion, by its terms, excluded all injuries arising from the discharge of pollutants. The contractor and the homeowner then entered into a settlement by which the contractor stipulated to a judgment to be pursued only against ProBuilders. The homeowner then sued ProBuilders for breach of contract and insurance bad faith.

The Washington Supreme Court held that regardless of the fact that carbon monoxide is a pollutant to which the pollution exclusion clearly applied, "the analysis does not end. Courts must next consider whether . . . the excluded occurrence is in fact the efficient proximate cause of the claimed loss." The court concluded that coverage was available for the injury because of the "efficient proximate cause rule."

The efficient proximate cause rule is a property insurance concept which explains how to determine whether coverage exists when both covered and excluded causes of loss are involved in the same claim. The court described the rule as follows:

"[T]he rule of efficient proximate cause provides coverage where a covered peril sets in motion a causal chain, the last link of which is an uncovered peril. If the initial event, the 'efficient proximate cause,' is a covered peril, then there is coverage under the policy regardless whether subsequent events within the chain, which may be causes-in-fact of the loss, are excluded by the policy."

The court then reasoned that the contractor's initial defective installation of the water heater vent was a covered occurrence of negligent construction (*i.e.*, a covered accident under the policy) and

Contact: Jack Levy | www.smithfreed.com | email: jlevy@smithfreed.com
Ph: 503.227.2424 | Fax: 503.227.2535 | 111 SW 5th Ave, Suite 4300 | Portland | OR | 97204

Smith Freed Eberhard

CONSTRUCTION CASE UPDATE

Oregon and Washington

case in point ...

Insurance coverage cases with "Okay" and "Awful" results

that the defective installation was also the efficient proximate cause of the homeowner's injury. Under the rule, coverage is not defeated by the fact that carbon monoxide discharge into the home (the excluded cause) was in fact the immediate cause which injured the homeowner.

Further, the court reaffirmed that Washington rejects "anti-concurrent cause" language in policies, language which is intended to defeat the application of the efficient proximate cause rule. The pollution exclusion included the following anti-concurrent cause provision:

"This Exclusion applies regardless of the cause of the pollution and whether any other cause of said bodily injury, property damage, or personal injury acted jointly, concurrently, or in any sequence with said pollutants or pollution. This Exclusion applies whether any other cause of the bodily injury, property damage, or personal injury would otherwise be covered under this insurance…"

This provision was held to be unenforceable:

"The exclusion cannot eviscerate a covered occurrence merely because an uncovered peril appeared later in the causal chain. The efficient proximate cause rule exists to avoid just such a result, ensuring that an insurance policy offering indemnity for a covered peril will provide coverage when a loss is proximately caused by that covered peril. Inasmuch as the causation language in the pollution exclusion here conflicts with established Washington law, it cannot defeat Xia's recovery as assignee of rights under the policy."

Candidly, the rationale for the Xia decision is hard to track. On a basic level, the court may just be simply expanding its commitment to consumer friendly solutions:

"We have never before suggested that the rule of efficient proximate cause is limited to any one particular type of insurance policy. Instead, the rule has broad application whenever a covered occurrence under the policy—whatever that may be—is determined to be the efficient proximate cause of the loss . . . Having received valuable premiums for protection against harm caused by negligence, an insurer may not avoid liability merely because an excluded peril resulted from the initial covered peril."

And as solace to the insurers, the court tossed out the idea that a narrowly tailored exclusion may just do the job:

"If ProBuilders sought to avoid liability for damages resulting from particular acts of negligence, it certainly could have written specific exclusions to that effect—for instance, an exclusion for acts of negligence relating to the installation of home fixtures generally or hot water heaters specifically. [What is not allowed is] the use of broad policy language which eliminates the relevance of the efficient proximate cause rule under all possible circumstances. We [do] not forbid the use of clear policy language to exclude a specifically named peril from coverage.

However, we struggle to understand how this alternative logic would work. Should the water heater installer's insurance policy exclude coverage for the installation of water heaters? If so, what coverage would it be left with? More importantly, however, the challenge here really involves reconciling property insurance concepts in a liability coverage analysis. Like plugging a square peg into a round hole, it just doesn't fit. For background on the efficient proximate cause rule, a comprehensive article titled The History of Proximate Causation can be found at https://www.irmi.com/articles/expert-commentary/the-history-of-proximate-causation. In essence, property insurance is written to cover losses to defined (scheduled) property that are "caused by" a covered peril, by either "named perils" (*i.e.*, fire, windstorm) or on an "all risk" basis (*i.e.*, losses arising from any fortuitous cause except those that are specifically excluded). In other words, property coverage is all about what caused the loss, whether or not the cause(s) are covered, and under what circumstances. The efficient proximate cause rule was developed to guide that analysis.

In contrast, liability insurance coverage is typically triggered by a broad grant of coverage promising to pay for the insured's legal liability to third parties

Contact: Jack Levy | www.smithfreed.com | email: jlevy@smithfreed.com

Ph: 503.227.2424 | Fax: 503.227.2535 | 111 SW 5th Ave, Suite 4300 | Portland | OR | 97204

case in point ...

Insurance coverage cases with "Okay" and "Awful" results

when there is an "occurrence" (an accident) which results in "bodily injury" or "property damage". Liability coverage is typically not limited to a particular property or to particular claimants. Further, what caused the occurrence is irrelevant. Once the occurrence (i.e., negligent constriction) and resulting injury or damage are established, coverage is then restricted or eliminated by exclusions "arising out of" myriad causes, for example: the contractor's own product and work, pollution, employer's liability, aircraft/auto/watercraft and other causes. In addition, there are separate kinds of insurance policies available for purchase to cover these specifically excluded categories of damages, such as pollution coverage, employer's liability coverage, and commercial auto coverage. With its conflation of liability and property insurance concepts of causation, the Xia decision will likely create a lot of confusion and litigation over what exclusions are enforceable. It may also have the effect of increasing the cost of liability insurance for all Washingtonians, especially if the liability policy is to be read as potentially covering all categories of harm.

As a closing note, even though the Washington court has never before incorporated this property insurance concept into the analysis of liability policies (and to our knowledge neither has any other court in the nation), the court held that ProBuilders owed a defense to the contractor and that it acted in bad faith by failing to do so:

"Although we have never before applied the rule to a case with facts such as these, we see no reason to depart from the policies underpinning the rule's function . . . . The record suggests that, prior to declining coverage, neither ProBuilders nor [its third party administrator] NBIS conducted any investigation into Washington law that might have alerted them to the rule of efficient proximate cause and this court's unwillingness to permit insurers to write around it. Accordingly, ProBuilders wrongfully refused to defend its insured after receiving Xia's complaint."

The bad faith damages to which ProBuilders is exposed to may be significant, and this fact pattern highlights the especially harsh consequences of failing to defend a case in Washington. Short of a legislative solution, insurers will likely find themselves in Catch-22 situations regarding any exclusion having a causal relationship to the injury or damage. In those circumstances, the safer route would likely be to defend the claim under reservation of rights and then seek a declaratory judgment on the coverage. Although, that begs the question of whether you really want the answer that awaits you.

Case updates are intended to inform our clients and others about legal matters of current interest. They are not intended as legal advice. Readers should not act upon the information contained in this article without seeking professional counsel.

Contact: Jack Levy | www.smithfreed.com | email: jlevy@smithfreed.com
Ph: 503.227.2424 | Fax: 503.227.2535 | 111 SW 5th Ave, Suite 4300 | Portland | OR | 97204