APPLIED SPECIALTY UNDERWRITERS

CASUALTY SPOTLIGHT™

VOLUME 1

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California

An Insurer's Defense Pursuant to a Reservation Does Not Itself Create a Conflict of Interest Requiring the Appointment of Independent Counsel

In *Colony Insurance Co. v. Glenn E. Newcomer Construction*, 2021 U.S. Dist. LEXIS 147238 (N.D. Ca. August 5, 2021), the insured, Glenn E. Newcomer Construction ("Newcomer") was allegedly the general contractor on a residential construction and remodeling project in San Francisco. Newcomer, among others, was sued in state court by the owner for breach of contract, negligence and fraud stemming from cost overruns and construction defects. Newcomer denied have ever performed work, provided workers and/or provided work product for the project. Colony Insurance Company ("Colony") was Newcomer's general liability insurer during the relevant period. *Id*. at 2.

Colony agreed to defend Newcomer pursuant to a full reservation of rights, while contending that no coverage was owed based upon various policy provisions and exclusions. It assigned counsel for Newcomer and thereafter filed a declaratory judgment action in the district court seeking a ruling that (1) coverage was not owed; and (2) it was entitled to reimbursement of defense costs in the underlying action. Newcomer filed a counterclaim against Colony for breach of contract, anticipatory breach and breach of the covenant of good faith and fair dealing. *Id.* at 3-4.

Newcomer asserted that Colony breached the insurance contract (among many reasons) by failing to provide Newcomer with independent counsel to defend the underlying action. It relied upon Section 2860 of the California Civil Code, which notes:

> [i]f the provisions of a policy of insurance impose a duty to defend upon an insurer and a conflict of interest arises which creates a duty on the part of the insurer to provide independent

> counsel to the insured, the insurer shall provide independent counsel to represent the insured (unless the insured waives the right to independent counsel in writing). *Id*. at 8 (citing Cal. Civ. Code § 2860 (a)).

Specifically, Newcomer asserted, by counterclaim, that an actual conflict of interest mandating independent counsel was present:

> [A] conflict of interest has arisen which mandates provision of independent counsel because the issues in the Underlying Action related to whether Newcomer performed any work, provided any workers or product at and/or for the Condo are also key to coverage in the Instant Action. If Newcomer did work at the Condo, that might afford support for one of Colony's exclusionary arguments made against coverage in the Instant Action while perhaps having an adverse effect on settlement and/or defense of the Underlying Action. *Newcomer, supra*. at 11.

Colony did not dispute that independent counsel is owed to an insured where an actual conflict of interest in defending the underlying action is present. However, it moved to dismiss the counterclaim based upon the view that no conflict existed based upon the explanation raised by Newcomer (i.e. whether it or did not work on and/or provide workers on the condo project). Colony noted that this was not a factual issue that could be "influenced or controlled" by Colony's counsel. *Id*. at 12-13.

In granting Colony's motion, the district court agreed that the defense of an insured pursuant a reservation of rights, absent a specific conflict of interest, was not enough to warrant the appointment of independent counsel:

> This allegation (noted above), which is difficult to follow, does not satisfy Newcomer's obligation to set forth a clear description of the basis for Colony's reservation of rights and explain how that reservation of rights has "cause[d] [the] assertion of factual or legal theories which undermine or are contrary to the positions to be asserted" in Underlying Action…Newcomer's position that the dispute creates the "possibility" of a conflict is plainly insufficient; "[t]he conflict must be significant, not merely theoretical, actual, not merely potential…
>
> In sum, the court concludes that the second amended counterclaim does not plausibly allege the existence of an actual conflict of interest supporting Newcomer's right to independent counsel. *Id*.

California has long recognized an insured's right to independent counsel (often referred to as "Cumis" counsel) where a conflict of interest in defending the underlying action is present. *See, San Diego Navy Federal Credit Union v. Cumis Insurance Society, Inc*. 162 Cal. App.3d 358 (1984). This typically takes the form of an issue where the outcome can be "controlled or influenced" by counsel and is otherwise determinative of coverage. Here, the court correctly understood that the issue upon which Newcomer sought to create a conflict, in fact, presented no conflict at all.

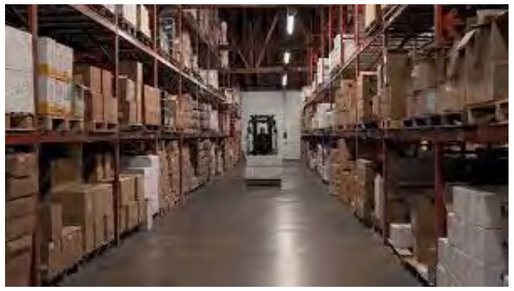
New Jersey

Building Owner Not Entitled to Reform Tenant's CGL Policy to Secure Additional Insured Status Based Upon Mutual or Unilateral Mistake

In *Affiliated FM Ins Co. v. Rothschild Realty I, L.P.*, 2021 N.J. Super LEXIS 1661 (App. Div. August 6, 2021), Rothschild Realty ("Rothschild") owned a warehouse at which it leased space to Universal Carpet Design ("Universal") beginning in 2004. The lease required Universal to obtain insurance coverage naming Rothschild as an additional insured. *Id*. at 1-2.

Universal engaged an insurance agency (Walsdorf) to obtain insurance. Walsdorf completed an application listing Universal as the applicant while identifying the property subject to the lease. Within the application, under a section entitled "Additional Interest/Certificate Recipient", was listed "Ed J. Drennan" who was described as a "50 percent owner of Universal" and also the "Building Owner." Walsdorf sent the application to another agency (Heffner), which secured property and general liability coverage for Universal from Harleysville Insurance Company ("Harleysville"). Universal renewed this coverage on largely identical terms for the next 10 years. *Id*. at 2-4.

In 2014, the warehouse collapsed and another tenant's merchandise was destroyed. Affiliated FM Insurance Company ("Affiliated"), Rothschild's general liability insurer at that time, paid the other tenant for its loss. It thereafter sued Universal and Rothschild in subrogation seeking to recover the amount paid the other tenant. When Harleysville denied coverage to Rothschild on the grounds it was not an additional insured under its policies, Rothschild filed a third-party action against Harleysville. *Id*. at 1-2.



Rothschild sought reformation of the Harleysville policy to include it as an additional insured. After extensive discovery into the underwriting and placement of coverage for Universal, the trial court granted summary judgment to Harleysville and Rothschild appealed. *Id*. at 6-9.

The appellate court initially noted that courts will reform a contract in light of a mutual mistake where: (1) both parties agree at the time they attempt to reduce their understanding to writing; and (2) the writing fails to express that understanding correctly. *Id.* at 10-11 (citing *St. Plus X House of Retreats, Salvatorian Fathers v. Diocese of Camden*, 88 N.J. 571 (1982). Rothschild renewed its argument that

Universal and Harleysville intended to insure the owner of the building and that a mutual mistake warranted reformation. *Rothschild, supra*. at 10.

The appellate court noted the significance of the testimony of Harleysville's underwriter, who (1) reviewed and approved Universal's application; (2) believed Drennan to be the owner of the building; and (3) charged Universal a smaller premium for Drennan's additional insured status because he understood he was the owner and tenant:

> A review of the presented facts does not support a finding of mutual mistake. Harleysville did not make a mistake in issuing the insurance policies. The original insurance application was prepared by Walsdorf on behalf of Universal...Harleysville issued the policies as requested in the application, listing "Ed J Drennan" as he additional insured on the endorsement. [ ] Moreover, (underwriter) testified that Universal was only charged an additional $50 premium for the added coverage because, according to the application, "Mr. Drennan…owned the property that he was also insuring as the owner of (Universal)…" (Underwriter) advised that "had it been a different business that owned the building other than Ed Drennan, it's a different exposure and I would have sought further information."

Therefore, Rothschild has not produced clear and convincing proof that any entity including Universal, Walsdorf, or Harleysville intended to include Rothschild as an additional insured under the Policy. *Id*. at 11-12.

Rothschild alternatively sought reformation on the grounds that Harleysville's conduct was "unconscionable" in the face of a unilateral mistake. To prove this theory, one must demonstrate that "a mistake on the part of one party is accompanied by fraud or other unconscionable conduct on the part of the other party." Rothschild argument rested principally on the Heffner Agency's possession of a certificate of insurance (authored by Walsdorf) in 2013 identifying Rothschild as an additional insured on the Harleysville policy. Rothschild asserted that knowledge of this certificate by an agent should be imputed to Harleysville, which should have led to an investigation and correction of the policy. *Id*. at 12-13.

The appellate court noted Rothschild never established that (1) Harleysville ever possessed or knew of the certificate; or (2) Harleysville knew that Rothschild owned the warehouse before the roof collapse. After highlighting the undisputed fact that Harleysville informed its agents (including Heffner) that they had no authority to bind additional insured coverage, the appellate court rejected Rothschild's "unconscionability" argument:

> The application requested Drennan be covered as an additional insured as the owner of the warehouse. Harleysville complied with the request and provided insurance coverage to Drennan as an additional insured. The insurance policies clearly identified Drennan as the additional insured. The same coverage was renewed year after year without objection by either Universal or Rothschild. Neither entity ever notified Harleysville of any error. Neither Universal nor Rothschild ever refused acceptance of the policy as written.

We are satisfied Harleysville did not act unconscionably in issuing the Universal policy as it had no knowledge of the mistake made by Universal's representative on the application. Nor was Harleysville ever informed by Universal or Rothschild during the many years of renewal that the policy was incorrect or unacceptable. Rothschild has not demonstrated a right to reformation. *Id*. at 14-15 (citations omitted).

The *Rothschild* decision highlights the importance of precision in completing an application and in reviewing the subject policy(ies) upon issuance. Regardless of the intent of the insured, Harleysville acted appropriately in placing and pricing coverage given the information it was provided. This problem may have been avoided if, at any point during 10 years of coverage, an insured had bothered to closely read the policy.

New York

"Most We Will Pay" and "Limits" Clauses Within Additional Insured Endorsement Unambiguously Limit Amount of Coverage Available Under Primary Policy

In *Zurich Am. Ins. Co. v. XL Ins. Am., Inc.*, 2021 U.S. Dist. LEXIS 153908 (S.D.N.Y. August 16, 2021), D.A. Collins ("Collins") entered a construction contract with the City of New York. It subcontracted some of the work to Hayward Baker, Inc. ("HBI"), the subcontract for which required that Collins and the City be named as additional insured's on HBI's policy. *Id*. at 2.

The subcontract required that HBI secure general liability coverage in the amount of $1,000,000 per occurrence with a $2,000,000 aggregate and umbrella excess coverage in the amount of $5,000,000 per occurrence/aggregate. An employee of Collins was injured on the construction site, who thereafter filed a lawsuit against the City, which impleaded HBI on theories of indemnification and contribution. *Id*. at 2, 7.

XL Insurance America ("XL") issued a primary general liability policy to HBI's parent company (Keller), but HBI was a named insured under the policy. The policy's limits were $2,500,000 per occurrence and in the aggregate, subject to a $650,000 deductible. XL also issued Keller/HBI an excess policy with limits of $6,000,000 per occurrence and in the aggregate. There was no dispute that the City qualified as an additional insured under the XL policies. *Id*. at 3.

Zurich American Insurance Company ("Zurich") issue primary and commercial umbrella policies to Collins for the relevant period. Zurich's primary policy included limits of $2,000,000 per occurrence with a $4,000,000 aggregate. Zurich agreed to defend the City in the underlying lawsuit. It thereafter filed a declaratory judgment against XL seeking to determine their respective rights under their policies, specifically (1) what the available limit was under the XL primary policy; and (2) whether the XL excess policy needed to respond before the Zurich primary policy. *Id*. at 3-5.

The XL primary policy included dozens of near identical additional insured endorsements providing coverage for liability "caused, in whole or in part," by HBI. Each endorsement included three provisions, including (as described by the court):

The Broader Clause

> If coverage provided to the additional insured is required by contract or agreement, the insurance afforded to such additional insured will not be broader than that which you are required by the contract or agreement to provide for such additional insured.

The Limits Clause

> We will not provide Limits of Insurance to any additional insured person or organization that exceeds the lower of:
>
> (a) The Limits of Insurance provided to you in this policy;
> (b) The Limits of Insurance you are required to provided in the written contract or agreement.

The Most We Will Pay Clause

> If coverage provided to the additional insured is required by a contract or agreement, the most we will pay on behalf of the additional insured is the amount of insurance:
>
> 1. Required by the contract or agreement;
> 2. Available under the applications Limits of Insurance shown in the Declarations, whichever is less. *Id*. at 4-5.

Zurich sought a declaration that XL's available primary limits were $2,500,000 and that XL's excess policy needed to respond before the Zurich primary policy. The district court found that XL's available primary limit was only $1,000,000 pursuant to the Broader Clause and Zurich's primary policy needed to respond before XL's excess policy. Zurich filed a motion for reconsideration of both rulings.

On reconsideration, Zurich argued that the Most We Will Pay Clause was dispositive and set the maximum amount XL would be required to pay under its primary ***and*** excess policies in light of the $6,000,000 in total limits required by the subcontract. Zurich asserted there was "thus no basis for XL to reduce its primary policy limit from $2.5M to $1M." XL pointed to the Limits Clause within the additional insured endorsement in its primary policy as clearly capping the XL primary policy at $1,000,000. *Id*. a 9-11.

While conceding it had erred in relying upon the Broader Clause in ruling for XL, the district court nonetheless confirmed XL's applicable primary limit was capped at $1,000,000. In doing so, it relied upon the plain language of the endorsement:

> Both the "Limits" Clause and the "Most We Will Pay" Clause limit the *amount* of insurance coverage to the lesser of the amount provided in the XL Primary Policy ($2,500,000) or the amount provided in the additional insured contract or agreement. Here, the lesser amount provided in an additional insured contract or agreement is $1,000,000, the figure referenced in the Court's opinion. The HBI Subcontract explicitly limits HBI's obligation to obtaining Commercial General Liability Insurance coverage in an amount of $1,000,000 per occurrence and $2,000,000 aggregate on an ISO occurrence form.
>
> Zurich only arrives at the $6 million figure and the argument that XL is required to provided primary insurance to a limit of $2.5 million by conflating primary and excess insurance and disrespecting the integrity of three different insurance policies. The HBI Subcontract requires HBI only to acquire "umbrella/excess coverage… sufficient to provide a total of $5,000,000 per occurrence/aggregate." It does not require HBI to acquire a primary policy in the amount of $6 million or a combination of policies that total $6 million. *Id*. at 12-13.

The district court also (again) rejected Zurich's argument that XL's excess policy only applies after Zurich's primary policy responds. While the XL excess policy included a provision that said "it is agreed that to the extent insurance is afforded to any Additional Insured under this policy, this insurance shall apply as primary and not contributing with any insurance carried by such additional insured…", the court noted this clause did not dictate when the excess policy was triggered in the first instance:

> As a general matter under New York law, an excess policy is not triggered until all primary policies have been exhausted. That is true even if the primary policy contains an "other insurance" clause. In order to preserve the hierarchy among tiers of insurance, New York courts "construe such a clause in a policy otherwise providing primary coverage as addressed to insurance on

the same level, not to higher levels of insurance, in order to avoid 'distort[ing] the meaning of the terms of the policies involved'" …

The primary insurance clause endorsement in the XL Excess Policy also provides, however, that the excess coverage will be primary only after the XL Excess Policy is triggered in the first place. That is the meaning of the language in the XL Primary Policy of "insurance is afforded to any Additional Insured under *this* policy. If the XL Excess Policy is not triggered there would be no insurance afforded to an additional insured under the primary. In other words, the XL Excess Policy is primary only once it is triggered, once all other primary policies have been exhausted. The primary insurance clause endorsement does not make the XL Excess Policy primary to the Zurich Primary Policy. *Id*. at 20-21 (citations omitted).

The *Zurich* decision presents a curious read, in that it appears the parties' and the court's thinking shifted a bit on reconsideration. That said, the district court's ruling in favor of XL is consistent with the language within the additional insured endorsement and New York law on priority of coverage.

Pennsylvania

Employee Exclusion Bars Coverage to Additional Insured Despite Insurer Failing to Raise Exclusion for Six Months

In *Westminster Am. Insurance Co. v. Security National Ins. Co*., 2021 U.S. Dist. LEXIS 154065 (E.D. Pa. August 16, 2021), Chester was the owner of property in Philadelphia. It hired Altman Management Company ("Altman") to maintain and manage the property, which in turn hire AM Marlin Construction ("AM Marlin") to repair a leak in the building's ceiling. Two men, Argenis and Waldy, were employed by Altman and AM Marlin, respectively. As they removed construction debris while standing on a balcony, the balcony collapsed and injured both men. *Id*. at 3-4.

AM Marlin was the named insured on a general liability policy issued by Security National Insurance Company ("SNIC"). Chester and Altman were additional insureds under the policy based upon the policy's Additional Insureds – Owners, Lessees or Contractors Endorsement, "but only to the extent that [Chester or Altman was] held liable for [AM Marlin's] acts or omissions arising out of [AM Marlin's] ongoing operations" at Chester's property. Chester was itself the named insured under a CGL policy and excess policy issued by Westminster American Insurance Company ("Westminster"). *Id*. at 4-5.

Upon receipt of Argenis' claim against Chester, AM Marlin and Waldy, Westminster tendered Chester's defense to SNIC on December 26, 2019. SNIC responded that it would investigate the claims and, on January 15, 2020, informed Westminster that it "had identified coverage issues." On April 3, 2020, still not having been told of SNIC's coverage position, Westminster sent a letter to SNIC requesting a formal response while adding that SNIC was "impeding [Argenis and his wife's] ability to settle [their] claims against Chester." *Id*. at 5.

SNIC reiterated that it had "identified coverage issues which may preclude coverage" and, on May 6, 2020, formally issued a written denial. In it, SNIC stated that coverage was not triggered for Chester because "AM Marlin did not perform any work for [Chester] on the property's fire escape balcony that collapsed." SNIC refused to reconsider its position in advance of a May 13, 2020 pre-suit mediation, at which Argenis and his wife settled their claims against Chester and Waldy for $30,000,000, including $5,000,000 available under Westminster policies. Chester granted Argenis any further rights Chester might have against SNIC to collect the balance of the judgment. *Id.* at. 6-8.

On May 21, 2020, SNIC's coverage counsel sent a letter to Westminster which (for the first time) stated coverage to Chester or any other insured was foreclosed by SNIC's Employer's Liability Exclusion. Following SNIC's continued denials, Argenis and Westminster (collectively "plaintiffs") initiated a declaratory judgment action seeking defense costs, indemnity and bad faith damages in excess of SNIC's policy limits. SNIC moved to dismiss the action for failure to state a claim. *Id*. at 8-9.

The Employer's Liability Exclusion ("ELE") in SNIC's policy precluded coverage for "bodily injury" to:

> (1) an "employee" … of any insured arising out of and in the course of (a) Employment by any insured; or (b) Performing duties related to the conduct of an insured's business.

The ELE applied "[w]hether an insured may be liable as an employer or in any other capacity. *Id*. at 14.

SNIC asserted the ELE was unambiguous and clearly barred coverage to Chester or Waldy because Argenis was an employee of Altman – an additional (or "any") insured under the policy. The district court agreed, relying exclusively upon the language of the exclusion:

> [t]he ELE exclusion explicitly excludes coverage for bodily injury to an employee of "any insured." The Complaint asserts, and it is undisputed, that Argenis was an employee of Altman, which is listed in the Policy's Schedule as an additional insured. Under the plain language of the Policy, Altman therefore qualifies as an insured under the Policy and the ELE precludes coverage for the bodily injury claims of its employee, Argenis, and for (his wife's) related loss of consortium claim. Accordingly, we conclude that, under the terms of the Policy, SNIC is not required to defend and indemnify either

Chester or Waldy against the claims asserted by Argenis. *Id*. at 19-20.

Plaintiffs alternatively raised the argument that SNIC should be estopped from raising the ELE because it had waited to do so until (1) nearly six months after having received the original tender; (2) after it had issued its original denial; and (3) after the mediation it had otherwise refused to attend. To prove estoppel is warranted, a plaintiff must establish that (1) an inducement that causes one to believe the existence of certain facts; (2) justifiable reliance on the inducement; and (3) prejudice to the one who relies if the inducer is permitted to deny the existence of such facts. *Id*. at 20 (citations omitted).

Ultimately, the court rejected the estoppel argument made against SNIC. Contrary to that imposed on other insurers, SNIC (1) had not assumed the defense pursuant to reservation; (2) had advised Westminster within a month of the tender that it had "identified coverage issues"; (3) had formally denied coverage prior to the mediation on the grounds that liability did not arise out of AM Marlin's operations; and (4) consistently declined to reconsider its denial. The court district court summarily stated:

Accepting these allegations as true, we can only reasonably infer that Chester and Waldy were aware that SNIC had identified coverage issues less than a month after Westminster's tender and were formally notified that SNIC had denied coverage on May 6, 2020, prior to attending the mediation. Therefore, in contrast to the insured in *Selective Way*, SNIC never agreed to defend [Chester and Waldy] and did not similarly "lull [Chester and Waldy] into a sense of security to their detriment." *Id*. at 21-23 (citing *Selective Way Ins. Co. v. MAK Services, Inc.*, 232 A.3d 762 (Pa. Super. Ct. 2020).

The *Westminster* court's enforcement of the "any insured" language in the Employer's Liability Exclusion is an obvious result and speaks to the care an additional insured should take in examining coverage under a subcontractor's policy. The more interesting portion of the opinion relates to estoppel. While the court concluded estoppel was not warranted, the fact the Employer's Liability Exclusion was not raised for nearly six months appears inexplicable. Other jurisdictions and/or courts may not have been as kind to SNIC in addressing this issue.

Casualty Spotlight

Texas

No Duty to Defend Where Allegations of Damage From Stormwater Runoff Could Not Be Separated from Polluted Contents of Stormwater

In *Liberty Mutual Fire Ins. Co. v. Copart of Conn., Inc.*, 2021 U.S. Dist. LEXIS 157457 (N.D. Tex. August 20, 2021), Copart of Connecticut, Inc. ("Copart") owned over 300 acres of land upon which it operated a machine salvage junkyard in South Carolina. A creek originating on Copart's property ran through and/or fed wetlands on several neighbors' property. *Id*. at 1-2.

In 2016, six neighboring property owners ("plaintiffs") filed a lawsuit against Copart in South Carolina alleging pollution related damages. Specifically, they alleged that in 2013, Copart cleared trees and other vegetation on approximately 30 acres of land and filled that parcel with wrecked/salvaged machinery. Plaintiffs alleged that many wrecked or salvaged vehicles stored on this parcel leaked gasoline, oil, hydraulic fluids, antifreeze and other hazardous fluids/materials into the soil. *Id*. at 2-3.

Plaintiffs alleged that Copart altered the normal course of stormwater runoff from is property. During periods of significant rainfall, plaintiffs alleged that water, soil, sediment, hazardous materials and chemicals were washed from Copart's property onto the plaintiffs' property. Scientific testing allegedly revealed elevated levels of heavy metals and other hazardous substances. Plaintiffs asserted theories of negligence, trespass, nuisance, and various violations of state and federal environmental statutes. *Id*. at 3-4.

Copart was insured under general liability policies issued by Liberty Mutual Fire Insurance Company ("Liberty") for the relevant period. Upon receipt of the underlying suit, Liberty agreed to defend Copart pursuant to a reservation of rights. Liberty then filed a declaratory judgment action in Texas seeking a ruling that it had no duty to defend or indemnify Copart and that it had the right to withdraw from the defense at any time. *Id*. at. 4-5.

Liberty argued that all claims brought against Copart were barred by the pollution exclusion within each of its policies. Each exclusion stated that coverage would not apply to bodily injury or property damage which would not have occurred but for "the actual, alleged, or threatened discharge, dispersal, seepage migration, release or escape of 'pollutants' at any time. The policies defined "pollutants" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot,

fumes, acids, alkalis, chemicals and waste." *Id*. at 5-6.

Copart contended Liberty Mutual had a duty to defend the entire lawsuit if it included a single claim that could potentially trigger coverage. Specifically, Copart asserted the underlying complaint included allegations that "water" and other natural substances ran from its property and damaged the plaintiffs' property, which by themselves could not be considered "pollutants" subject to the exclusion. Copart cited cases outside of Texas within which allegations of damage based upon the presence of water could not be considered pollution. *Id*. at 10-11 (citing *Nationwide Mut. Ins. Co. v. Boyd Corp*., 2010 U.S. Dist. LEXIS 5438 (E.D. Va. January 25, 2010) and *Builders Mut. Ins. Co. v. Half Court Press, LLC*, 2020 U.S. Dist. LEXIS 78727 (W.D. Va. August 3, 2010).

The district court distinguished these cases by pointing out they included allegations of water damage independent of polluted stormwater. In ruling for Liberty, the court concluded that one could find no such distinction:

> In this case, the Court does not find any allegations within the four corners of the underlying complaint that allege damages only from water, as opposed to polluted water. Copart cites two examples in its brief in response to (Liberty's) motion that it contends are analogous to the allegations in *Boyd* and *Half Court Press*. First, Copart contends the (plaintiffs) alleged "harm caused by stormwater." But this is not a factual allegation in their complaint; this quote is from a statement about South Carolina laws….
>
> Next, Copart points to the following allegation under the trespass claim: "[Copart's actions constitute a trespass and continuing trespass by encroachment of water, sediment, and other matter onto Plaintiff's property." But other allegations under this claim and throughout the complaint make clear the origin of damages was "the flow of stormwater laden with soil, sediment, and harmful chemicals" onto (plaintiffs') property. The complaint cannot be read to allege damage from non-polluted water alone. The Court finds further support for this conclusion in the fact that the actual harm the (plaintiffs') allege is cloudy water and damage to flora and fauna from the water laden with chemicals and sediment. *Copart, supra*. at 11-12.

The district court did not address Copart's argument that Liberty's umbrella policies owed a duty to defend based upon an exception to its policies' pollution exclusion because each policy included a retained limit of $1,000,000 that had not been breached. *Id*. at 12-13.

Copart highlights the situation where a court refuses to ignore the complaint as a whole. In the district court's view, there was no way to segregate the damage alleged from stormwater runoff from the pollutants contained within the stormwater itself. Had the underlying complaint made a clearer distinction between "water damage" and "pollution," the result may have been different.

Casualty Spotlight

Wisconsin

"Shooter's Endorsement" in CGL Policy Bars Coverage for Injuries to Volunteer Worker at Fireworks Show

In *T.H.E. Insurance Co. v. Spielbauer Fireworks Co*., 2021 U.S. Dist. LEXIS 150592 (E.D. Wis. August 11, 2021), Spielbauer Fireworks Company ("Spielbauer") was in the business of selling fireworks and putting on fireworks displays. Prior to July 4, 2018, Spielbauer sold fireworks to the City of Land O'Lakes, but was not in charge of the city's fireworks display. A volunteer worker lighting fuses (Zdroik) was injured when struck by a shell during the July 4th fireworks show. *Id*. at 2.

Zdroik sued Spielbauer and its general liability insurer, T.H.E. Insurance Company ("THE"), in state court seeking compensation for his injuries. THE thereafter filed a declaratory judgment action in district court asserting there was no coverage under its primary and excess policies for Zdroik's injuries. *Id*. at 2-3.

The THE primary policy included a form titled Shooters Endorsement – Fireworks ("Shooter's Endorsement"), which provided:

> This policy shall NOT provide coverage of any kind (including but not limited to judgement costs, defense, cost or defense, etc.) for claims arising out of injuries or death to shooters or their assistants hired to perform fireworks displays or any other persons assisting or aiding in the display of fireworks whether or not any of the foregoing are employed by the Named Insured, any shooter or any assistant.

THE's excess policy followed form to its primary policy and incorporated the Shooter's Endorsement by reference. *Id*. at 5-6.

Spielbauer argued that the Shooter's Endorsement could not exclude coverage for injury to a volunteer worker, given (1) Zdroik was not "hired to perform fireworks displays" and (2) a volunteer worker could not fit within the "any other persons…" section of the endorsement without rendering the first section of the exclusion superfluous. THE moved for judgment on the pleadings asserting that the Shooter's Endorsement was unambiguous and barred coverage Zdroik's injuries. *Id*. at 6.

In granting THE's motion for judgment, the district court noted that the endorsement was only capable of a single reading that precluded coverage:

> It is evident from a plain reading of the Shooters Endorsement that it does not cover claims arising out of injuries or

death to hired shooters, their assistants, or any other person assisting or aiding in the display of fireworks, regardless of whether they were employed by Spielbauer, any shooter, or any assistant. Even though Zdroik was not a shooter hired to perform fireworks displays, he is "any other persons assisting or aiding in the display of fireworks." In other words, because Zdroik assisted in the display of fireworks, the Shooter's Endorsement bars coverage for his claim. *Id*. at 7-8.

The district court further rejected Spielbauer's argument that the court should defer judgment on the question of indemnity until liability in the underlying action had been established. The court summarily dismissed this request, knowing Wisconsin courts universally hold that "where there is no duty to defend there is also no duty to indemnify." *Id.* at 8 (citing Great Lakes Beverages, LLC v. Wochinski, 373 Wis. 2d 649 (Wis. 2017).

The *Spielbauer* case illustrates how some insureds attempt to create ambiguity where none exits. The district court made the right decision in finding the Shooter's Endorsement clearly applied to Zdriok's injuries.

Federal Appellate Cases

Third Circuit

Duty to Defend Owed for Allegations of Intentional Trespass Where Possibility Existed That Some Encroachments Were the Result of Negligence

In Westminster Am. Ins. Co. v. Spruce 1530, 2021 U.S. App. LEXIS 24822 (3rd Cir. August 19, 2021), Spruce 1530, LLC ("Spruce") constructed an apartment building adjacent to another developer's property (Touraine) in Philadelphia. In 2015, Touraine sued Spruce for trespass on the grounds Spruce had built a portion of the apartment building on Touraine's property. The court held Spruce was negligent with respect to determining the location of the property line before beginning construction. *Id.* at 1-2.

In 2017, Touraine filed a second lawsuit against Spruce alleging an additional eight violations of its property line. Touraine's complaint was supported by an expert survey and alleged that each encroachment was an intentional trespass and violated Touraine's demand that Spruce cease any unlawful forms of trespass onto the Touraine property." *Id.* at 2-3.

Westminster American Insurance Company ("Westminster") issued a general liability policy to Spruce for all relevant periods. Westminster denied coverage for the 2017 action on the basis that the tort at issue was an intentional trespass and thus not an "occurrence" or "accident" covered by the policy. Westminster filed a declaratory judgment action in the district court and moved for summary judgment on the duty to defend. The district court ruled in favor of Spruce and Westminster appealed. *Id.* at 1, 4.

On appeal, Westminster argued the trespass was an intentional tort because Spruce refused to remove the additional encroachments after the property line was resolved in the initial action. Upon reviewing Pennsylvania's "four corners" rule as applied to the 2017 action, the court of appeals agreed that Spruce was again owed a defense:

> Pennsylvania follows the "four corners" rule to determine if an insured owes a duty to defend a policyholder. An analysis of the duty to defend thus requires the district court to compare the four corners of the policy in question to the four corners of the underlying complaint. If the complaint alleges an injury which *may* be within the scope of the policy, the company must defend the insured until the insurer can confine the claim to a recovery that the policy does not cover. The district court must also scrutinize the factual allegations in the complaint to avoid "artful pleadings designed to avoid exclusions in liability insurance policies…
>
> We agree that the property line was resolved by the court's ruling in *Touraine I*. Nevertheless, as the district court quite appropriately recognized, there is a possibility that the encroachments documented in 2017 by [consultant] resulted from Spruce 1530's negligence with respect to the property line as opposed to an intentional trespass. The district court found "no indication" that Touraine attempted to limit its factual allegations by requesting damages to the encroachments during a specific timeframe. Thus, a reasonable factfinder could determine the encroachments were a result of Spruce 1530's negligent failure to determine the site of the property line.
>
> Westminster has a duty to defend against the entire underlying action if any of the claims could potentially be covered. Since it is possible the encroachments were a result of negligence, we conclude that the district court did not err in finding Westminster had the duty to defend. *Id*. at 4-5.

The *Spruce* decision is a useful reminder that "labels" on causes of action within a pleading (i.e. intentional trespass) will not govern the duty to defend if the allegations otherwise support the potential for coverage. What is interesting about the opinion (albeit without the benefit of the actual pleading) is it appears the

allegations of intentional trespass related to Spruce's decision to continue its encroachment *after* the property lines were made clear by the original litigation. Obviously, the court saw the allegations as suggesting broader theories of recovery.

Ninth Circuit

Insurer Reserving Right to Seek Reimbursement of Defense Costs Was Entitled to Recovery Where No Duty to Defend Existed and Insured Accepted Defense Pursuant to Reservation

In *Nautilus Insurance Co. v. Access Medical, LLC*, 2021 U.S. App. LEXIS 23541 (9th Cir. August 9, 2021), Access Medical, LLC ("Access") was in the business of selling medical devices. At some point, the partnership "soured" and one of the principals ("Switzer") filed suit against other principals alleging they had and were interfering with Switzer's business relationships with hospitals. Respondents tendered the lawsuit to Access' general liability insurer, Nautilus Insurance Company ("Nautilus"), asserting that the suit sought damages because of "personal and advertising injury" (i.e. oral or written publication of material that libels or slanders a person or organization). *See, Nautilus Ins. Co. v. Access Medical, LLC*, 482 P.3d 683, 686 (Nev. 2021).

Nautilus initially denied coverage, but thereafter agreed to defend the insured pursuant to a reservation of rights. Specifically, it reserved the right to seek reimbursement of defense costs if a court determined there was no potential for coverage. The insured(s) did not object and Nautilus began to defend the suit. Simultaneously, Nautilus filed a declaratory judgment in Nevada federal district court seeking a ruling that it had no duty to defend or indemnify the insureds. *Id*.

The district court granted Nautilus summary judgment on the issue of the duty to defend, which decision was affirmed by the Ninth Circuit Court of Appeals. The district court had originally denied Nautilus' motion seeking reimbursement of defense costs pursuant to its original reservation of rights, which Nautilus appealed. The Ninth Circuit thereafter certified a question to the Nevada Supreme Court, which it framed as follows:

> Is an insured entitled to reimbursement of costs already expended in defense of its insureds where a determination has been made that the insurer owed no duty to defend and the insurer expressly reserved its right to seek reimbursement in writing after defense has been tendered but where the insurance policy contains no reservation of rights?

Casualty Spotlight

Nautilus contended that it was entitled to reimbursement under a theory of unjust enrichment or quasi-contractual rights, while the insureds contended that the insurance policy must govern the issue and included no provision with regard to the reimbursement of defense costs. *Id*., 482 P.3d at 685-686, 687.

Initially, the Nevada Supreme Court articulated that (1) the insurance contract did not govern any issue beyond coverage; (2) a party that performs a disputed obligation may be entitled to reimbursement under a theory of unjust enrichment, which it described as follows;

> Unjust enrichment has three elements: "the plaintiff confers a benefit on the defendant, the defendant appreciates such benefit, and there is acceptance and retention by the defendant of such benefit under such circumstances that it would be inequitable for him to retain the benefit without payment of the value thereof." When the insurer furnishes a defense, it is clear that the insurer has conferred a benefit on the policyholder, and that the policyholder appreciates it. The issue is whether equity requires the policyholder to pay. *Id*., 482 P.3d at 688 (citations omitted).

In ruling in favor of Nautilus, the supreme court cited, with approval, the Restatement (Third) of Restitution & Unjust Enrichment § 35 (2011) as applied to an insurance policy:

> The Restatement (Third) of Restitution and Unjust Enrichment provides that "[i]f one party to a contract demands from the other a performance that is not in fact due by the terms of their agreement, under circumstances making it reasonable to accede to the demand rather than insist on an immediate test of the disputed obligation, the party on whom the demand is made may render such performance under protest or with reservation of rights, preserving a claim in restitution to recover the value of the benefit conferred in excess of the recipient's contractual entitlement."…
>
> We are persuaded by the Restatement's reasoning. When time is precious, it makes sense for the parties to decide quickly what to do, and to litigate later who must pay. Because an insurer risks unbounded liability if it loses the coverage dispute after refusing to defend a suit, it is generally "reasonable for the insurer to accede to the demand rather than to insist on an immediate test of the disputed obligation." Under these circumstances, we conclude that when a court determines that the insurer never had a duty to defend, and the insurer clearly and expressly reserved its right to seek reimbursement, it is equitable to require the policyholder to pay. Therefore, we

> hold that when a court finally determines that an insurer had no contractual duty to defend, the insurer may ordinarily cover in restitution if it has clearly reserved its right to do so in writing. *Access Medical*, 482 P.3d at 689 (citations omitted).

The Ninth Circuit, relying upon the supreme court's ruling, reversed the district court and granted Nautilus a right of restitution. It further remanded for discovery and briefing on Nautilus' incurred costs and what may be "necessary or proper" reimbursement. *Access Medical*, 2021 U.S. App. LEXIS 23541 at 4-5.

As a strong dissent in the supreme court decision lays bare, the issue of reimbursing an insurer for costs associated with a defense pursuant to a reservation is often fraught with peril. Beyond the legal arguments on both sides, what does an insurer do if the insured rejects the offer of such a defense? Is it comfortable with an insured defending a claim for which it may have some doubts as to its denial? For the insured, can it afford to defend a disputed claim without agreeing to such terms? What the *Access Medical* decision does make clear is that an insurer in Nevada must expressly condition its offer of a defense on reimbursement for restitution to apply.

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