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Defects and Denials in Dixieland

I. Reservation of Rights Letters

A. South Carolina: New pitfalls created by Harlesyville v. Heritage

Writing an effective Reservation of Rights letter is an important tool for an insurance carrier. Knowing the requirements for an effective ROR for each jurisdiction is key to writing an effective ROR and protecting the carrier. The South Carolina Supreme Court has just recently decided a pivotal case addressing the required elements for an ROR under South Carolina law. The Court held that reservation of rights letters must give fair notice to the insured that the insurer intends to assert defenses to coverage or to pursue a declaratory relief action. Without this information, the insured has no reason to act to protect its rights because it is unaware of the conflict of interest that exists between itself and the insurer. The insurer must specify in detail any and all bases upon which it might contest coverage in the future. In addition, the insurer must inform the insured of the need for an allocated verdict as to covered versus noncovered damages, and of the insured's interest in obtaining a written explanation of the award that will permit the parties to determine which part of the verdict is covered. The carrier must be careful to avoid the pitfalls in South Carolina so as to not waive any coverage defenses.

B. Florida: Pitfalls related to consent to settle

There is a trend among certain jurisdictions to allow policyholders to settle claims without their insurer's consent, if the insurer has offered to defend under a reservation of rights. The theoretical basis for such rulings is that such insurers have breached their absolute duty to defend. Specifically, in Florida, where an insurer offers to defend pursuant to a reservation of rights, the insured initially retains the "right to reject the

defense and hire its own attorneys and control the defense." *Bellsouth Telecomm., Inc. v. Church & Tower of Fla*., Inc., 930 So. 2d 668, 671-72 (Fla. 3d DCA 2006). However, by accepting and not rejecting an insurer's fully-funded defense, the insured agrees to leave control of the defense in the insurer's hands. Where an insured has accepted a defense subject to a reservation of rights, the insured may not subsequently "wrest control of the defense and bind the insurer to [a] settlement." *Zurich Am. Ins. Co. v. Frankel Enters., Inc*., 509 F. Supp. 2d 1303, 1312 (S.D. Fla. 2007). The panel will explore such rulings in Florida and contrast them to other Southeastern states that have not followed the trend.

II. Independent Counsel

The right to independent counsel varies from state to state. Some states consider the issuance of a Reservation of Rights an automatic conflict entitling the insured to an independent counsel to be retained by the carrier. Other states look at the conflict on a case-by-case basis.

In Mississippi, the courts have recognized a right to independent counsel in conflict situations. As established in *Moeller v. Am. Guar. & Liab. Ins. Co.*, 707 So. 2d 1062, 1070 (Miss. 1996), if an insurance policy covers only a portion of a claim, or only one theory of liability, but not another portion of a claim or theory of liability, there may be a conflict of interest. The right to independent counsel in these situations provides the insured opportunity to select his own counsel. Failing to provide Moeller counsel in conflict situations may estop the carrier from asserting coverage defenses. The carrier will need to be cognizant of whether a conflict exists when confronted with claims in Mississippi. For over 20 years, the case law was uncertain as to whether defense costs incurred by Moeller counsel could erode the limits of a burning-limits policy. A recent Fifth Circuit decision, *Federal Ins. Co. v. Singing River Health System*, has held that the Moeller counsel fees, under Mississippi law, are paid by the insured and erode limits.

In other states, such as Florida, the right to independent counsel is statutory. Under the Claims Administration Act (Fla. Stat. § 627.426(2)) an insurer is required to retain "independent counsel which is mutually agreeable to the parties" after issuing a reservation of rights to assert a coverage defense. When a carrier offers to defend under a reservation of rights, the policyholder may, at its own election, reject the defense and retain its own attorneys without jeopardizing his right to seek indemnification from the carrier for liability. If the defense if not adequate and it is reasonable for an insured to retain its own counsel, then an insured my recoup attorney's fees from an insurer because it has, in effect, forced the insured to retain its own counsel.

III. Rip & Tear Coverage

Rip and Tear coverage covers the cost of tearing out a contractor's bad work due to defects that make its inclusion in the project unsafe. The normal method of providing this coverage is by endorsement to the commercial general liability (CGL) policy. For coverage to apply, the work must fail to meet contractual specifications or other industry standards that apply to the type of construction into which the materials were incorporated. The primary markets for rip and tear and contractors rework coverage are concrete and masonry contractors. Claims professionals can usually find the right answer by asking two fundamental questions: (1) what do we need to "access"; and (2) what do we need to "rip and tear" to access it? With these two points clarified, it is much easier to approach each state's substantive law that controls the definition of "property damage" and the applicability of policy exclusions.

Florida adopted coverage for "rip and tear" claims in *Carithers v. Mid-Continent Cas. Co*., 782 F.3d 1240 (11th Cir., April 7, 2015). In *Carithers*, the insured was a general contractor that built a new home including a balcony. *Id*. The district court found that the balcony was defectively constructed, which caused damage to the garage. *Id*. The insurer and insured agreed that the resulting damage in the garage was "property damage" caused by an "occurrence" and therefore covered by the standard CGL policy at issue. *Id*. However, in order to repair the garage, the balcony had to be rebuilt. Id. The insurer contended that the cost to tear out the balcony was not covered, but the district court (and the Eleventh Circuit) disagreed.

More recently, the Texas Supreme Court opinion in *U.S. Metals, Inc. v. Liberty Mutual Group* (Texas 2016) adopted coverage for costs to access non-covered faulty workmanship. The panel will discuss the implications of the *U.S. Metals* decision, including: (1) whether a CGL insuring agreement covers consequential damages if there is no covered "property damage"; (2) whether the intentional destroying of property can be an "occurrence"; (3) applicability of certain policy exclusions; and (4) whether the policy period in effect at the time of the repair is triggered. The topic will provide guidance to adjusters on responding to coverage requests for these types of claims in Texas, Florida, and elsewhere.

IV. Notice/Voluntary Payments

Most policies contain a clause barring coverage in the event that an insured makes a payment to a third party and then seeks reimbursement from the insurer. A common form of such a provision provides 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." In the standard commercial general liability (CGL) coverage form, such a prohibition is included as one of the insured's "Duties in the Event of Occurrence, Claim or Suit." Various states in the Southeast have addressed the notice requirement and voluntary payment prohibition. Likewise, in Texas, the Supreme Court has held proof of prejudice is required for an insurer to disclaim coverage for a voluntary payment, even if there were uncovered claims. This becomes significant for contractors that step-in to resolve problems quickly, despite, for whatever reason, no consent having been provided by the insurer, such as, because it is still investigating the claim.

In stark contrast, the courts of Georgia and Alabama have enforced both Notice and Voluntary Payment conditions without looking for prejudice. Indeed, a Georgia court recently enforced a notice condition in a standard CGL policy because the catch-all "no suit" clause served to make all conditions a "condition precedent" to coverage. Policy language that merely requires the insured to give notice of a particular event does not by itself create a condition precedent. However, a general provision that no action will lie against the insurer (or "we may not be sued") unless the insured has fully complied with the terms of the policy will suffice to create a condition precedent. Notably, most standard CGL policies contain such a clause. The panel will discuss this and other recent rulings.

V. Duty to Defend under Right-To-Repair Statutes

Insurers have two significant obligations to their insureds under a commercial general liability (CGL) policy: a duty to defend, and a duty to indemnify. The duty to defend is a contractual obligation almost always found in CGL policies and, as the costs of litigation continue to rise, is often considered to be more valuable to an insured than the duty to indemnify. The trigger of the duty to defend can vary depending on the state. The carrier should be aware of the scope of the duty to defend for jurisdiction where the claim is pending.

The duty to defend has been questioned and tested recently in Texas and Florida with regard to "right to repair" statutes. When faced with pre-litigation notice of defects, can a policyholder receive an investigation and defense at its insurer's expense?

The courts of Texas have considered the duty to defend under that state's right to repair statute ("RCLA") and ruled in the negative. *Hardesty Builders, Inc. v. Mid-Continent Cas. Co., Inc*., Civ. No. C-10-142, 20110 WL 5146597 (S.D.Tex December 13, 2010) (holding that SIRP did not trigger a duty defend because it did not constitute a

"suit" pursuant to the policy). Accordingly, there is no duty to defend the RCLA process, and Builders is not required to reimburse the insured's defense costs incurred during this process.

The Supreme Court of Florida has been asked to determine Chapter 558 sets forth a pre-suit process that allows a property owner to serve a contractor, subcontractor or design professional with a written notice of claim of an alleged construction defect. In response, the contractor may inspect or otherwise investigate the defect within a prescribed time, serve a copy of the notice on other parties the contractor believes responsible, or serve a written response offering to remedy the defect, offering to settle the claim, or disputing the claim. If the contractor disputes the claim or fails to respond within the prescribed time, the property owner may then proceed with a civil action or arbitration proceeding against the contractor.