CLM 2016 National Construction Claims Conference
September 28-30, 2016
San Diego, CA

Coverage and Extra-Contractual Claims: A Construction Defect Perspective

I. COVERAGE ISSUES

A. Must the insured directly tender to its insurer in order to trigger an insurer's duties under a policy?

State	Short Answer	Explanation
WA	Yes	Washington is a "selective tender" jurisdiction, meaning that the insured must first tender a claim before an insurer has any legal obligation to provide coverage. *Mutual of Enumclaw v. USF Ins. Co.*, 191 P.3d 866 (Wash. 2008).
OR	Notice is required, but that notice doesn't necessarily need to come from the insured	In Oregon, an "insurer must receive a copy of the pleading so that it may review the allegations to determine whether there is coverage" and that "[n]otice of the claim is a condition precedent to the duty to defend." *Oregon Ins. Guar. Ass'n v. Thompson*, 760 P.2d 890 (Or. 1988). Formal tender of notice by the insured is also not a condition precedent to an insurer's duty to defend; actual notice from any source is sufficient. *Bailey v. Universal Underwriters Ins. Co.*, 474 P2d 746 (Or. 1970); *American Star Ins. Co. v. Allstate Ins. Co.*, 508 P2d 244 (Or. 1973).
AK	Unclear	The Alaska courts have not directly addressed whether an insured must directly tender to the insurer in order to trigger the insurer's duties.
ID	Unclear	The Idaho courts have not directly addressed whether an insured must directly tender to the insurer in order to trigger the insurer's duties.

Common examples of when this issue arises:

- Insurer receives notice directly from the claimant / plaintiff but not from the named insured or any additional insured.

- Insurer receives notice of a claim from an additional insured but not from the named insured.
- Insurer receives notice of a claim from a named insured but not from any of the additional insureds.

B. Are pre-tender defense costs covered?

State	Short Answer	Explanation
WA	Yes, unless the insurer was prejudiced	The Supreme Court of Washington has held that "the duty to defend arises not at the moment of tender, but upon the filing of a complaint alleging facts that could potentially require coverage. ... Accordingly, an insured can recover pretender fees and costs except where a late tender prejudiced the insurer." *National Sur. Corp. v. Immunex Corp.*, 297 P.3d 688 (Wash. 2013).
OR	No	Oregon courts have held that the legal obligation to provide a defense does not arise until tender, and hence, there is no duty to reimburse the insured for pre-tender defense cots. *Oregon Ins. Guar. Ass'n v. Thompson*, 760 P.2d 890, 893 (Or. 1988).
AK	Unclear	The Idaho courts have not directly addressed whether an insured can recover its pre-tender defense costs.
ID	Generally, no, unless the insured had no choice but to incur the cost before tendering to the insurer	The Idaho federal trial courts have held that the voluntary payments provision bars pre-tender defense costs. *See Blue Cross of Idaho Health Serv. v. Atlantic Mut. Ins. Co.,* No.1:09-CV-246 (D. Idaho Jan. 19, 2011). But the courts have held that such costs are covered if they were incurred out of necessity and before the insurer could have made a coverage determination. *Huntsman Advanced Materials, LLC v. OneBeacon Am. Ins. Co.*, 2011 U.S. Dist. LEXIS 81672 (D. Idaho).

Common examples of when this issue arises:
- An additional insured has been receiving a defense from their primary insurer before tendering to their other insurers that provide additional insured coverage.
- The named insured has been funding their own defense before tendering to an insurer.

C. Can extrinsic evidence be used to deny a duty to defend?

State	Short Answer	Explanation
WA	No, but extrinsic evidence can be considered to trigger a duty to defend	Once the insured tenders a defense, then the duty defend is determined by the "eight corners" of the complaint and policy. *Expedia, Inc. v. Steadfast Ins. Co.*, 329 P.3d 59 (Wash. 2014). Extrinsic evidence can also be considered in determining a duty to defend but only in order to trigger the duty to defend, not to deny coverage. *Woo v. Fireman's Fund Ins. Co.*, 164 P.3d 454

		(Wash. 2007).
OR	Generally, no, but with a few narrow exceptions	Once an insurer receives notice, the duty to defend is determined by looking at the allegations in the complaint in comparison with the policy. *Ledford v. Gutoski*, 877 P2d 80 (Or. 1994). Unlike Washington, extrinsic evidence is generally not considered when determining a duty to defend. *Bresee Homes, Inc. v. Farmers Ins. Exch.*, 293 P.3d 1036 (Or. 2012). There are some narrow exceptions to the "no extrinsic evidence" rule, one of which is discussed below.
AK	No, but extrinsic evidence can be considered to trigger a duty to defend	The Alaska Supreme Court has held that insurers are forbidden from denying a defense based on extrinsic evidence. *See Alaska Department of Transportation v. State Farm Fire & Cas. Co.*, 939 P.2d 788 (Alaska 1997). However, an insurer must consider extrinsic evidence if it triggers a duty to defend. *See Great Divide Ins. Co. v. Carpenter*, 79 P.3d 599, 616 (Alaska 2003)
ID	No	The Supreme Court of Idaho has held that the determination of the duty to defend is limited to the allegations in the complaint. *Hoyle v. Utica Mut. Ins. Co.*, 48 P.3d 1256 (Id. 2002)

Common examples of when this issue arises:

- Extrinsic evidence establishes that the insured completed its work before the policy incepted, and the policy specifically excludes completed work.
- Extrinsic evidence establishes that damage is limited to the insured's work and therefore falls squarely within the "your work" exclusion.
- Extrinsic evidence establishes that no third-party property damage occurred during the policy and therefore the insuring agreement is not triggered.

D. Can extrinsic evidence be considered to determine whether a person or entity qualifies as an additional insured under the policy?

State	Short Answer	Explanation
WA	Yes (at least insofar as the federal courts are concerned)	The state courts have not addressed this issue. But the federal trial courts in Washington have held that extrinsic evidence is admissible to consider whether a person or entity qualifies as an insured. *See e.g. Hartford v. Leahy*, 2011 WL 813458 (W.D. WA 2011); *See also Staheli v. Chicago Ins. Co.*, 2016 WL 2930444 (W.D. Wash.) (holding that the duty to defend rules that restrict the inquiry to just the policy and complaint only applies to an *insured* seeking a defense).
OR	Yes, under certain narrow circumstances	An insurer may rely on extrinsic evidence to determine whether an entity or person qualifies as an additional insured. *Fred Shearer & Sons, Inc. v. Gemini Ins. Co*., 240

		P.3d 67 (Or. 2010). But extrinsic evidence can only be considered if it is impossible to tell from the complaint and policy that an entity or person qualifies as an additional insured. *QBE Ins. Corp. v. Creston Court Condominium, Inc.*, 58 F.Supp.3d 1137 (D. Or. 2014).
AK	Unclear	No state or federal court has addressed the issue under Alaska law.
ID	Unclear	No state or federal court has addressed the issue under Idaho law.

Common examples of when this issue arises:

- Extrinsic evidence establishes that the named insured completed its work before the policy incepted, and the additional insured coverage only applies to ongoing work.
- Extrinsic evidence shows that there was no written agreement to provide additional insured coverage, and the policy requires there to be a written agreement.

E. Do anti-indemnity statutes limit the scope of coverage available to an additional insured (*ie.* does the statute close the "additional insured loophole")?

State	Short Answer	Explanation
WA	No*	RCW 4.24.115 prohibits a subcontractor from indemnifying a general contractor for that general contractor's sole or partial negligence. The statute does not apply to limit coverage under insurance policies, however, such as agreements to provide coverage to an additional insured. *See Int'l Marine Underwriters v. ABCD Marine, LLC*, 313 P.3d 395 (Wash. 2013).
OR	Yes	Or. Rev. Stat. § 30.140 prohibits a subcontractor from indemnifying a general contractor for that general contractor's sole or partial negligence. The statute also prohibits additional insured coverage for the additional insured's sole or partial negligence. See e.g. Cont'l Cas. Ins. Co. v. Zurich Am. Ins. Co., 2009 WL 231462 (D. Or.).
AK	No*	Alaska Stat. § 45.45.900 prohibits a subcontractor from indemnifying a general contractor for that general contractor's sole negligence. The statute specifically does not apply to insurance contracts such as those for additional insured coverage.
ID	Unclear*	Idaho Rev. Stat. § 29-114 prohibits a subcontractor from indemnifying a general contractor for that general contractor's sole negligence. There is no case law addressing whether the statute applies to limit coverage under insurance policies.
*** Note:** The 2013 ISO revisions to the additional insured endorsements provide that additional insured coverage will not be broader than the named insured's indemnity obligation to the additional insured. The new additional insured endorsements are intended to provide additional insured coverage that is congruent with the named insured's indemnity obligations,		

including the limitations imposed by anti-indemnity statues.

Common examples of when this issue arises:

- The additional insured coverage provides coverage that is broader than the scope of the indemnity agreement between the named insured and the additional insured.
- The additional insured seeks coverage for its own negligence, sole or partial, which it would not be permitted to seek under the indemnity agreement with the named insured.

F. Is defective construction "property damage" and/or an "occurrence"?

State	Short Answer	Explanation
WA	Yes, even if the damage is to the insured's own work	Unintentional construction defects generally constitute an "occurrence" and "property damage" under Washington law, even if the damage is to the insured's own work. *Diamaco, Inc. v. Aetna Cas. & Sur.*, 983 P.2d 707 (Wash. 1999); *Yakima Cement Prods. Co. v. Aetna Cas. & Sur.*, 608 P.2d 254 (Wash. 1980). Moreover, the legal theory attached to the claim – whether it be breach of contract, negligence, etc. – is generally irrelevant. *See Mid-Continent Cas. Co. v. Titan Constr. Corp.*, 281 Fed. Appx. 766 (9th Cir. 2008). It is the factual allegations and not the legal theories that are relevant. *Id.*
OR	No if the defect and damage are solely a breach of contract, but yes if negligent construction has caused damage	There is no "occurrence" where construction defects are merely the result of a breach of contract. *Oak Crest Const. Co. v. Austin Mut. Ins. Co.*, 998 P.2d 1254 (Or. 2000). But negligent construction that causes resultant damage generally does constitute an "occurrence" and "property damage" under Oregon law. *Willmar Development, LLC v. Illinois Union Ins. Co.*, 464 Fed. Appx. 594 (9th Cir. 2011).
AK	Yes, if unintentional defective construction has caused damage to other non-defective property	Unintentional defective work that causes damage to other, nondefective property, generally does constitute "property damage" caused by an "occurrence." *Fejes v. Alaska Ins. Co., Inc.,* 984 P.2d 519 (Alaska 1999). The legal theories are irrelevant in determining whether there is "property damage" caused by an "occurrence." *Id.* It is the factual allegations and not the legal theories that are relevant. *Id.*
ID	Unclear	The Idaho courts have not directly addressed whether defective construction is an "occurrence" or "property damage."

Common examples of when this issue arises:

- Defective work has caused damage just to the defective work itself.
- Defective work has caused damage to other, non-defective work.

- The legal theory alleged against the insured is solely for breach of contact (at least in Oregon).

G. When are damages deemed to have occurred for purposes of triggering coverage (*ie.* what trigger theory applies to construction defect claims)?

State	Short Answer	Explanation
WA	Continuous / injury-in-fact	Under the "continuous trigger" rule, every policy spanning the period during which property damage progresses is liable for all damages attributable to the occurrence. *Am. Nat'l Fire Ins. Co. v. B & L Trucking Co*., 951 P.2d 250 (Wash. 1998); *Gruol Const. Co. v. Ins. Co. of N.Am*., 524 P.2d 427 (Wash. 1974). Although Washington courts refer to this as the "continuous trigger" rule, in reality, it operates more like an injury-in-fact trigger because the trigger depends on the actual occurrence of property damage during each policy.
OR	Injury-in-fact	The Oregon Supreme Court has held that the injury-in-fact theory applies to progressive environmental contamination claims. *St. Paul Fire & Marine Ins. Co. v. McCormick & Baxter Creosoting Co.*, 923 P.2d 1200 (Or. 1996). Oregon courts have extended the injury-in-fact trigger theory to damages caused by construction defects. *See Fountain Court Homeowners Ass'n v. Fountain Court Development, LLC*, 334 P.3d 973 (Or. 2014); *MW Builders, Inc. v. Safeco Ins. Co. of Am.*, 2009 WL 995050 (D. Or.).
AK	Unclear, but courts have applied an exposure trigger in environmental cases	The Alaska courts have not directly addressed when damages are deemed to have occurred in a construction defect case. Courts have applied the exposure theory to progressive environmental contamination claims. *Mapco Alaska Petroleum, Inc. v. Cent. Nat'l Ins. Co. of Omaha,* 795 F. Supp. 941 (D. Alaska 1991).
ID	Unclear, but courts have applied an injury-in-fact trigger in environmental cases	The Idaho courts have not directly addressed when damages are deemed to have occurred in a construction defect case. The Idaho Supreme Court has stated in *dicta* that an injury-in-fact theory should apply to latent and progressive environmental contamination claims. *N. Pac. Ins. Co. v. Mai*, 939 P.2d 570 (Idaho 1997).

Common examples of when this issue arises:

- The defective work was completed, and latent damage progressively occurred over the course of many policy years.
- The defective work was completed during the policy, but did not actually cause damage until after the policy expired.
- The insured performed work during the policy, but did not complete the work until after the policy expired, and the damage did not occur until after the work was completed.

H. Are "rip and tear" damages covered?

State	Short Answer	Explanation
WA	Yes	There is coverage in Washington for the cost to "rip and tear" into the insured's work if that is necessary to correct the resultant damage. *Mut. of Enumclaw v. T&G Construction, Inc.*, 199 P.3d 376 (Wash. 2008). Similarly, there is coverage for "rip and tear" to other contractor's non-defective work if it is necessary to correct the insured's defective work. *See e.g. Indian Harbor Ins. Co. v. Transform LLC*, 2010 WL 3584412 (W.D.Wash.). An example of the latter type of "rip and tear" is if the insured installed defective plumbing into a building. The cost to "rip and tear" out defective drywall to make repairs to the defective plumbing would be covered "rip and tear" damage.
OR	Yes	The Oregon Supreme Court has held that there is coverage for "rip and tear" to other contractor's non-defective work if it is necessary to correct the insured's defective work. *Wyoming Sawmills, Inc. v. Transportation Ins. Co.*, 578 P.2d 1253 (Or. 1978).
AK	Yes	At least one Alaska federal trial court has held that the costs of removing and replacing the insured's defective work is covered to the extent necessary to repair damage to third-party property. *Clear, LLC v. American & Foreign Ins. Co.,* 2008 WL 818978 (D. Alaska).
ID	Unclear	The Idaho courts have not directly addressed whether there is coverage for "rip and tear" costs.

Common examples of when this issue arises:

- The insured's defective work causes damage to underlying or integrated, non-defective, work. The insured's defective work needs to be "ripped and torn" out to repair that damage.
- The insured's defective work has not caused damage to other work, but other work needs to be damaged (*ie.* "ripped and torn" out) in order to repair the insured's defective work.

II. Extra-Contractual Issues

A. When does a wrongful denial of a defense amount to bad faith?

State	Short Answer	Explanation
WA	Unreasonable denial of defense is bad faith	An insurer is liable for bad faith if it unreasonably denies a defense. It is unreasonable to deny a defense where law or facts conceivably bring a claim within the scope of coverage under the policy. *Am. Best Foods, Inc. v. Alea London, Ltd.*, 229 P.3d 693 (Wash. 2010).
OR	Denial of a defense is not	Unlike Washington, in Oregon, a denial of a defense is a

	bad faith; it is only a breach of contract	breach of contract and does not give rise to bad faith liability. *Farris v. United States Fidelity & Guaranty Co.*, 587 P2d 1015 (Or. 1978). An insurer's obligations of good faith and fair dealing only give rise in the duty to defend context once an insurer has agreed to undertake the defense of the insured. *Strader v. Grange Ins. Co.*, 39 P.3d 903 (Or. 2002).
AK	Bad faith for an insurer to intentionally or recklessly deny coverage, and no reasonable basis must have existed for the denial	To prevail on a bad faith claim under Alaska law, a policyholder must establish the absence of a reasonable basis for denying benefits under the policy and the insurer's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim. *Hillman v. Nationwide Mut. Fire Ins. Co.*, 855 P.2d 1321 (Alaska).
ID	Bad faith for insured to intentionally and unreasonably deny coverage, where coverage was not fairly debatable and insurer's denial was not a good faith mistake	A bad faith claim under Idaho law exists where: "(1) the insurer intentionally and unreasonably denied or withheld payment, (2) the claim was not fairly debatable, (3) the denial or failure to pay was not the result of a good faith mistake, and (4) the resulting harm is not fully compensable by contract damages." *Lakeland True Value Hardware, LLC v. Hartford Fire Ins. Co.*, 291 P.3d 399 (Id. 2012).

Common examples of when this issue arises:

- Insurer denies a defense, but court later holds that there was a duty to defend.

B. When is an insurer liable for failure to settle?

State	Short Answer	Explanation
WA	Bad faith to unreasonably fail to settle a claim within policy limits where the insured's liability is reasonably clear and a reasonable opportunity to settle exists – insurer acts unreasonably and in bad faith if it does not give equal consideration to interests of its insured	The Washington Courts have also held that part of the duty to defend includes the duty to settle within policy limits where the insured is facing an excess exposure and the insurer is presented with an opportunity to settle within limits. *Besel v. Viking Ins. Co.*, 32 P.3d 283 (Wash.). Washington law requires insurers to attempt to settle claims in good faith if their investigation discloses a reasonable likelihood that its insured may be liable. *Truck Ins. Exch. of Farmers Ins. Group v. Century Indem. Co.*, 887 P.2d 455 (Wash. 1995). A duty to settle requires that there be a reasonable opportunity to settle within the policy limits. *See Cox v. Continental Cas. Co.*, 2014 WL 2011238 (W.D.Wash.). Good faith requires an insurer to give equal consideration to the interests of its insured. *Tank v. State Farm Fire & Cas. Co*., 715 P.2d 1133 (Wash. 1986); *See also Specialty Surplus v. Second Chance, Inc.*, 412 F.Supp.2d 1152 (W.D.Wash. 2006).
OR	Insurer is negligent if it fails to settle within policy limits	The Oregon Supreme Court has described the failure to settle standard as follows: "The insurer is negligent in

	where a reasonable opportunity to settle existed and a reasonable insurer would have settled under the circumstances	failing to settle, where an opportunity to settle exists, if in choosing not to settle it would be taking an unreasonable risk--that is, a risk that would involve chances of unfavorable results out of reasonable proportion to the chances of favorable results. Stating the rule in terms of 'good faith' or 'bad faith' tends to inject an inappropriate subjective element--the insurer's state of mind--into the formula. The insurer's duty is best expressed by an objective test: Did the insurer exercise due care under the circumstances?" *Georgetown Realty, Inc. v. Home Ins. Co.*, 831 P.2d 7 (Or.).
AK	Bad faith for insurer to reject an opportunity to settle within its policy limits there is a substantial likelihood of an excess verdict against the insured	The Supreme Court of Alaska held that "[w]hen a plaintiff makes a policy limits demand, the covenant of good faith and fair dealing places a duty on an insurer to tender maximum policy limits to settle a plaintiff's demand when there is a substantial likelihood of an excess verdict against the insured." *Jackson v. Am. Equity Ins. Co.*, 90 P.3d 136 (Alaska).
ID	Bad faith for insurer to reject an opportunity to settle within its policy limits by giving greater consideration to its own interests than to its insured's	The Supreme Court of Idaho has adopted the "equality of consideration" test to determine whether the insurer breached its duty of good faith in rejecting a settlement offer made by a third party. *Truck Ins. Exch. v. Bishara*, 916 P.2d 1275 (Id.) . The insurer must give "equal consideration" to the interests of its insured in deciding whether to accept an offer of settlement. *Id.* The court considers several factors in determining whether an insurer gave "equal consideration" such as: the strength of the injured claimant's case on the issues of liability and damages; whether the insurer has thoroughly investigated the claim; the failure of the insurer to follow the legal advice of its own attorney; any misrepresentations by the insured which have misled the insurer in its settlement negotiations; and any other factors which may weigh toward establishing or negating the bad faith of the insurer. *McKinley v. Guar. Nat'l Ins. Co.*, 159 P.3d 884 (Id.).

Common examples of when this issue arises:

- A policy limits demand is made against the insured.
- There is no settlement offer, but the insurer's investigation reveals a reasonable likelihood that the insured is liable.

C. What are the extra-contractual damages and penalties?

State	Short Answer	Explanation
WA	Coverage by estoppel for failure to defend or failure to	The penalty for bad faith denial of a defense or failure to settle is "coverage by estoppel" and a presumption that

	settle claims; Presumption that bad faith harmed the insured; Tort damages; Attorney fees; and Treble damages	the insurer's bad faith harmed the insured. *Safeco Ins. Co. v. Butler*, 823 P.2d 499 (Wash. 1992); *Besel v. Viking Ins. Co.*, 49 P.3d 887 (Wash. 2002). This means that an insurer that has denied a defense or failed to settle in bad faith will not be allowed to challenge coverage for any reasonable settlement entered into by the insured, or judgment entered against the insured. Moreover, the insured is also not required to prove that they were actually harmed by the insurer's bad faith conduct. Harm is presumed. The Washington State Supreme Court has acknowledged that the presumption of harm is virtually impossible to disprove. *Mut. of Enum. Ins. Co. v. Dan Paulson Const., Inc.*, 169 P.3d 1 (Wash.). The insured is also entitled to tort damages arising from the bad faith, which is in addition to the amount of the settlement or judgment. *Miller v. Kenny*, 325 P.3d 278 (Wash.). The insured is also entitled to attorney fees and up to treble the amount of damages under Washington's Insurance Fair Conduct Act, RCW 48.30.015.
OR	Judgment in excess of limits for failure to settle claims; Tort damages; Attorney fees; and Punitive damages	The insured can recover the amount of the judgment against the insured in excess of the policy limits where the insurer's failure to reasonably settle within the policy limits caused the excess judgment. *Goddard v. Farmers Ins. Co. of Oregon*, 637, 22 P.3d 1224 (Or. 2000). Tort damages are also recoverable, such as emotion distress. *McKenzie v. Pacific Health & Life Ins. Co.*, 847 P.2d 879 (Or. 1993). Attorney's fees may also be recoverable under ORS § 742.061. Punitive damages are also recoverable if the insured can establish by clear and convincing evidence that insurer acted with malice or has shown a reckless and outrageous indifference to its insured. ORS § 31.730.
AK	Judgment in excess of limits for failure to settle claims; Tort damages; Attorney fees; and Punitive damages	An insurer is liable for a judgment in excess of its policy limits where it failed to settle a claim. *Allstate Ins. Co. v. Herron*, 634 F.3d 1101 (9th Cir. 2011). Tort damages are also recoverable including but not limited to (1) mental distress, (2) damage to credit rating, (3) damage to reputation, (4) impairment of ability to obtain insurance and bonding, and (5) loss of earnings. *Alaska Pac. Assur. Co. v. Collins*, 794 P.2d 936 (Alaska). Attorney fees are also recoverable. *Hillman v. Nationwide Mut. Fire Ins. Co.*, 866 P.2d 1321 (Alaska). Punitive damages are also available for a showing of outrageous conduct. Alaska Stat. § 09.17.020.
ID	Tort damages; Attorney fees; and Punitive damages	In a third party action where the insurer unreasonably denies a settlement or payment, the insured would be able to recover contract damages up to the policy limits

		and then tort damages for any excess. *McKinley v. Guaranty Nat. Ins. Co.*, 159 P.3d 884 (Id.). Tort damages are recoverable as well. *White v. Unigard Mut. Ins. Co.*, 730 P.2d 1014 (Id.). Attorney fees are also recoverable, as well as punitive damages if the insured can prove by clear and convincing evidence, oppressive, fraudulent, malicious, or outrageous conduct by the insurer. *Weinstein v. Prudential Prop. & Cas. Ins. Co.*, 233 P.3d 1221 (Id.).