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The 1st Party Report

A Property & Insurance Updat

Spring 2010

Construction Defects: Definition of "Occurrence" in CGL Policies

By Fredric W. Stearns

The typical commercial general liability (CGL) policy provides coverage for property damage only if it results from an "occurrence," which is usually defined as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions." Georgia case law defines "accident" as "an unexpected happening rather than one occurring through intention or design." *Custom Planning & Development Inc. v. American Nat'l Fire Ins. Co.*, 270 Ga. App. 8, 606 S.E.2d 39 (2004). Despite this established definition, Georgia courts and their federal counterparts routinely interpret and apply the term "occurrence" quite differently in defective construction litigation even though the cases often involve identical policy language and similar facts.

However, a recent decision by the Georgia Court of Appeals, *Hathaway Development Company, Inc. v. American Empire Surplus Lines Ins. Co.,* 301 Ga. App. 65, 686 S.E.2d 855 (2009), may encourage Georgia federal courts to adopt the Georgia rationale in determining whether property damage resulted from an "occurrence." The court in *Hathaway* implicitly rejected the interpretation of the term "occurrence" routinely employed by Georgia federal courts in construction defect litigation, and observed, pointedly, that those decisions are not binding on Georgia courts.

The case of *Owners Ins. Co. v. James,* 295 F. Supp. 2d 1354 (N.D. Ga. 2003), illustrates the accepted application of the term "occurrence" in Georgia's federal courts. In *Owners,* the insured was sued by a homeowner who alleged that the home built by the insured was experiencing water intrusion due to faulty installation of a stucco exterior. The insurer contested the insured's right to coverage contending that the homeowner's claim did not allege an "occurrence" under the policy. The court agreed with the insurer. According to the court, installation of the stucco was not an "accident." Specifically, the court held that an "occurrence" only includes "injury *resulting from accidental acts* and not injury *accidentally caused by intentional acts*." *Id.* at 1364 (emphasis in original).

In other words, the manner in which the stucco was installed was not "accidental." It was intentionally and deliberately installed by the contractor. The fact that the contractor did not expect or anticipate the damage to occur as a result of its deliberate acts did not make those acts "accidental." For this reason, the court found that no "occurrence" was alleged as defined by the policy.

In contrast, Georgia courts considering liability coverage for property damage arising from defective construction hold that negligently performed faulty workmanship that damages other property may constitute an "occurrence" under a CGL policy. *Sawhorse v. Southern Guaranty Ins. Co.,* 269 Ga. App. 493, 604 S.E.2d 541 (2004). However, Georgia courts also routinely hold that there is no "occurrence" within the policy where the faulty workmanship causes damage only to the work itself. *See Custom Planning & Development Inc. v. American Nat'l Fire Ins. Co.*, 270 Ga. App. 8, 10, 606 S.E.2d 39, 41 (2004).

Thus, in defining an "occurrence" in construction defect cases, Georgia federal courts in diversity cases focus on the intent of the insured in performing the act causing property damage. Georgia courts focus on the negligence of the insured and whether that negligence damaged "other property." Applied strictly, the federal interpretation of "occurrence" likely benefits the insurer because construction is inherently an intentional act. No contractor accidentally installs a foundation.

The Georgia interpretation of "occurrence" potentially provides a greater likelihood of liability coverage to a negligent contractor depending upon the scope of that contractor's work on a given project. For example, in the case of an insured general contractor responsible for all the work on the project, the chances of damage to "other property" may be remote. All the property constitutes the work from the perspective of the general contractor; on new construction, as opposed to renovation work, for example, there is no "other property."

A subcontractor, however, likely has a limited scope of work, and the chance that it will negligently damage "other property" is not remote. For example, if a plumbing subcontractor negligently performs its work resulting in a water leak, the chance that "other property" (from the plumber's perspective), such as drywall or flooring, may be damaged is considerable.

In other words, under Georgia law, it appears that damage to "other property" cannot be the result of an "occurrence" unless the damage is to property beyond the scope of the insured's contract. As a result, a CGL policy may be considerably more valuable to a subcontractor than to a general contractor.

For more information on this topic, contact Fred Stearns at 404.888.6132 or fred.stearns@swiftcurrie.com.

Valued Policy Act: New Meaning for an Old Law?

By Amy Michaelson Kelly

The *New York Times* announced in September of 1885 that the Georgia legislature would be taking up the issue of whether to establish a valued policy law in Georgia. The *Times* noted that "Under the present system losses by fire are adjusted after the fire, the full amount of insurance being rarely paid." By 1900, Georgia was one of sixteen states with some form of valued policy law. Today, Georgia is one of over twenty states that has or has had a valued policy law.

Georgia's Valued Policy Act (the "Act") is unique among other states' valued policy laws. The Act provides as follows:

> (a) Whenever any policy of insurance is issued to a natural person or persons insuring a specifically described one or two family **residential building or structure** located in this state against loss by fire and the building or structure is wholly destroyed by fire without fraudulent or criminal fault on the part of the insured or one acting in his behalf, the amount of insurance set forth in the policy relative to the building or structure shall be taken conclusively to be the value of the property . . . .

O.C.G.A. § 33-32-5 (emphasis added). Notably, Georgia's Act only applies to total losses by fire of "residential buildings or structures." In most other states, valued policy laws generally apply to "real property" or a "building." *See, e.g.*, S.D. Codified Laws § 58-10-10 (2010); N.H. Rev. Stat. Ann. § 407:11 (2010); Kan. Stat. Ann. § 40-905 (2010). Wisconsin is the only state we identified that has a valued policy law that applies to "homes" in the popular sense of the word, but the wording of Wisconsin's statute differs from that of Georgia's. Wisconsin's valued policy law provides as follows:

> Whenever any policy insures **real property that is owned and occupied by the insured primarily as a dwelling** and the property is wholly destroyed, without criminal fault on the part of the insured or the insureds assigns, the amount of the loss shall be taken conclusively to be the policy limits of the policy insuring the property.

Wis. Stat. § 632.054 (2010) (emphasis added).

Despite the long history of Georgia's Act, there is relatively little jurisprudence elucidating on the Act in its 1971 form specifically regarding the definition of "residential building or structure." Wisconsin's Court of Appeals considered the meaning of the Wisconsin statute's requirement that the property be occupied by the insured "primarily as a dwelling" and concluded that property occupied primarily as a rental property is not property occupied primarily as a dwelling. *Cambier v. Integrity Mut. Ins. Co.*, 305 Wis. 2d 337, 341, 738 N.W.2d 181, 182 (Wis. Ct. App. 2007). In another case, the Court of Appeals rejected the argument of an insured's estate that had tried to enforce the valued policy law to receive the full extent of the policy limits. *Drangstviet v. Auto-Owners Ins. Co.*, 195 Wis. 2d 592, 601, 536 N.W.2d 189, 192 (Wis. Ct. App. 1995). The court interpreted the statute to "appl[y] to insureds, who are persons living in or actually using a residence or place of habitation," not to an estate. *Id.* at 600.

However, Georgia's statute is different. Wisconsin's statute requires the insured to reside in the dwelling, whereas Georgia's statute could require, like Wisconsin's statute, that someone (or, perhaps, specifically the insured) reside in the property or it could only require the property to be "residential" in nature. Georgia courts have never interpreted the word "residential" in the Act, but a Georgia court would most likely look to the word's plain meaning or to other statutes defining the word "residential."

Most homeowner's policies require an insured to reside at the insured location as a condition of coverage. Therefore, if an insured does not reside at the insured property, the insured does not receive any coverage, and the applicability of the Act is irrelevant. Other policies, such as landlords' insurance policies, may not contain a residency requirement, so if a rental property is vacant, for example, when it is destroyed by fire, there could arguably be an issue as to whether Georgia's Act applies to that property because no one resides there and, thus, it may not be a "residential structure." Georgia courts may not require an insured to reside at the insured location.

Possibly, the legislature's use of "residential building or structure" merely requires the property to be residential in nature. However, apply this requirement to the following scenario: an insured owns a home but does not reside there. Unquestionably, the home was "residential" in nature when it was built. Over a period of years, the home deteriorates to such a degree that it becomes uninhabitable. It is worth one-tenth of the policy limits of the insurance policy covering the property. Ironically (or not), the home burns, and the loss is covered by the policy. Is an uninhabitable home a "residential building or structure" and covered by the Act? This question has not been resolved by Georgia courts.

Georgia courts have stated that the general purpose of the Act is to serve as a liquidated damages provision because the homeowner's burden of proving the value of property after loss is "overwhelming." *See, e.g.*, *Marchman v. Grange Mut. Ins. Co.*, 232 Ga. App. 481, 484, 500 S.E.2d 659, 661 (1998). An uninhabitable structure or one in which the insured does not reside is no easier to evaluate after a total loss by fire, so a Georgia court may apply the Act to these types of structures. However, until a court makes a pronouncement on the meaning of "residential," there exist legitimate arguments regarding the applicability of the Act in these contexts.

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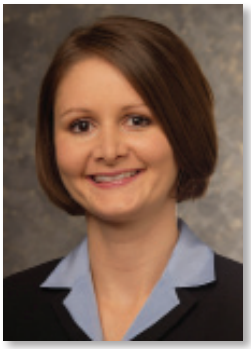
Georgia Case Law Update



By Brooke N. Williams

***Bickerstaff Imports, Inc. v. Sentry Select Ins. Co.*, 299 Ga. App. 245 (2009)**

In *Bickerstaff*, Bickerstaff Imports. Inc. d/b/a Southlake Mitsubishi ("Southlake") suffered certain losses resulting from a fraudulent scheme perpetrated by one of its salesmen beginning in August 2001. Southlake sought to recover its losses under a commercial crime policy issued by Sentry. The policy provided that "you [Southlake] may not bring any legal action against us [Sentry] involving loss … unless brought within 2 years from the date you discover the loss." Southlake submitted a proof of loss to Sentry in February 2003 which cited various dates for discovery of the loss, the latest date being December 12, 2002.

On February 5, 2003, Sentry rejected the claim because the Southlake salesmen's illegal activities were not shown to be a "direct theft loss" within the scope of the policy. Sentry reiterated its denial of the claim more than ten months later on December 29, 2003, and requested that Southlake provide Sentry with any "other information" it might have indicating that the losses were covered. The letter also said that Sentry "will contact you on this shortly." Sentry did not initiate any further contact with Southlake with regard to this claim until December 31, 2005. On January 13, 2006, Sentry advised Southlake that it continued to maintain its denial of the claim based on Sentry's determination that the loss did not result from "direct theft" within the meaning of the policy. Sentry also noted in the correspondence that the contract provided for a two-year limitation period.

Southlake filed suit against Sentry on December 29, 2006. Sentry sought summary judgment on the grounds that the suit was barred by the policy's two-year limitation period. The trial court granted summary judgment to Sentry. Southlake appealed and contended that a jury question existed as to when the loss was discovered, and that, even if the loss was discovered more than two years before the suit was filed, a jury question existed as to whether Sentry waived compliance with the two-year limitation period.

Southlake contended that it actually did not discover the loss until November 2005. However, the proof of loss and other correspondence indicated that Southlake had knowledge in 2003 and 2004. Using the latest of the dates given by Southlake for discovery of the loss, December 12, 2002, the contractual two-year limitation period expired on December 12, 2004. Accordingly, the court held that Southlake's December 29, 2006, complaint was time-barred.

The court also held that Sentry did not waive the policy's two-year limitation period by corresponding with Southlake. The correspondence was not intended to negotiate the claim and the last correspondence was sent by Sentry to Southlake on December 29, 2003, almost one year before the contractual limitation period expired on December 12, 2004.

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What Protection a Mortgagee is Afforded When Foreclosing Either Before or After a Fire Loss

By D. Barton Black

The law in Georgia regarding a lender's right to recover on a borrower's insurance policy covering his collateral is stated in *Decatur Fed. Savings & Loan Ass'n v. York Ins. Co.*, 147 Ga. App. 797, 798, 250 S.E.2d 524 (1978):

> Insurance policies regularly have one of two sorts of mortgagee payment clauses. Where the loss is paid to the loss payee named as its interest may appear this constitutes a simple or open-mortgage clause under which the mortgagee is a mere appointee of the fund whose right of recovery is not greater than that of the mortgagor…. Conversely, where the loss payable clause contains language stipulating that, as to the mortgagee, the insurance shall not be invalidated by any act or neglect of the mortgagor or owner of the property, the effect of such language, referred to as the New York standard, or union mortgage clause is to create a separate and distinct contract on the mortgagee's interest and give to it an independent status…. Thus, under the standard clause, the mortgagee may frequently recover although the insured owner could not.

Although a mortgagee's right to recover under a fire insurance policy ultimately depends upon the wording of the particular policy, court decisions reflect that a mortgagee's recovery is largely determined by which of the two main types of mortgage clauses applies to the mortgagee's claim. The first type of provision is the simple loss payable or "open mortgage" clause. This clause typically provides that any loss will be payable to the mortgagee as its interest may appear. This clause does not create a separate contract of insurance between the insurance company and the mortgagee so as to allow the mortgagee to recover regardless of the mortgagor's conduct. Furthermore, under the open mortgage clause, courts have held that the foreclosure of the mortgaged premises by the mortgagee breached the condition in the policy against a change of title and have denied the mortgagee recovery for a fire loss which occurred after the mortgagee foreclosed on the mortgaged premises.

The second type of clause that protects a mortgagee's interest is the standard or union mortgage clause. This provision provides that the

mortgagee's interest in the insurance funds will not be invalidated by any act or neglect of the mortgagor. This clause is generally regarded as creating a separate and independent contract of insurance between the insurer and the mortgagee, whereby the mortgagee's right of recovery under the policy is not affected by any act or omission of the mortgagor. The majority of courts, including Georgia, hold that under the standard mortgage clause, the mortgagee's foreclosure of the mortgaged premises is an increase in the mortgagee's insurable interest and does not constitute a change in title or ownership of the property. Thus, the mortgagee may recover under a standard mortgage clause for a fire loss that occurred subsequent to the mortgagee's foreclosure. *See Nat'l Sec. Fire & Cas. Co. v. Eureka Fed. Sav. & Loan Ass'n*, 188 Ga. App. 693, 373 S.E.2d 811 (1988).

Simple Mortgage Clause Under Georgia Law

Under Georgia law, a mortgagee, named as loss payee in an "open mortgage" clause of a fire insurance policy, is not entitled to recover for a fire loss which occurs after the mortgagee takes title to the mortgaged premises. *Southern States Fire & Cas. Ins. Co. v. Napier*, 22 Ga. App. 361, 361, 96 S.E. 15 (1918). Furthermore, the mortgagee is not protected if the insured commits some act or omission that violates a condition to coverage or otherwise invalidates the policy. *In re Brian Alexander*, 329 B.R. 919, 923 (Bankr. M.D. Ga. 2005) (*citing Black's Law Dictionary* 1034 (8th ed. 2004)). This clause makes the mortgagee merely an appointee to collect the insurance money due the insured; therefore, the mortgagee must claim in the right of the insured, not in the mortgagee's own right. *Ins. Co. of N. Am. v. Gulf Oil Corp.*, 106 Ga. App. 382, 385, 127 S.E.2d 43, 46 (1962).

Standard Mortgage Clause Under Georgia Law

Under a "standard mortgage clause" or a "union mortgage clause," the mortgagee is protected even if the insured does something to invalidate coverage. *S. Gen. Ins. Co. v. Key*, 197 Ga. App. 290, 292, 398 S.E.2d 237 (1990) *cert. denied*. The effect of the standard mortgage clause is to afford the mortgagee independent status of an insured under the policy of insurance. *Cherokee Ins. Co. v. First Nat'l Bank of Dalton*, 181 Ga. App. 146, 147, 351 S.E.2d 473 (1986). Despite the independent status afforded the mortgagee under a standard mortgage clause, that status is not without certain limits. For example, it is well settled that the mortgagee's interest in the property exists only to the extent of the indebtedness secured in the property and that it is consequently under an obligation to account to the borrower for any surplus received upon foreclosure. *See* 2 Pindar *Georgia Real Estate Law* §§ 21-88 (3rd ed.); *Palmer v. Mitchell County Fed. Sav. & Loan Ass'n*, 189 Ga. App. 646, 647, 377 S.E.2d 4, 6 (1988).

Therefore, insurance companies must pay attention to which type of mortgage clause is included in a fire loss policy in order to determine the mortgagee's rights to insurance proceeds based on whether a fire loss occurs before or after a foreclosure. The claims process may be needlessly complicated if the mortgagee's rights are not protected, and consequently, the carrier may be exposed to uninvited legal action.

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Joint Property Seminar with McAngus Goudelock & Courie, LLC
Friday, April 30, 2010
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"The Good, The Bad, The Ugly"
Joint WC Seminar with McAngus Goudelock & Courie, LLC
Thursday, May 13, 2010
11:00 am - 1:30 pm
Villa Christina - Atlanta, GA

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