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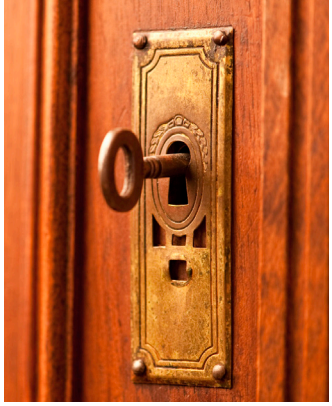

The 1st Party Report

A Property & Insurance Update

Fall 2016

Timeless Values. Progressive Solutions.

Droning On

By: Kori E. Eskridge

Craving a Slurpee but unable to break away from the office? Have no fear, the 7-Eleven drone is here! Earlier this year, 7-Eleven partnered with a start-up company to begin testing residential deliveries by drone of popular convenience store staples like coffee, donuts, candy, and yes, even Slurpees. *See* 7-Eleven Just Made the First Commercial Delivery by Drone (2016) http://www.theverge.com/2016/7/23/12262468/7-11-first-retailer-deliver-food-drone. 7-Eleven is not the first company to try delivery by drone – Amazon and Wal-Mart have been developing infrastructure and processes to make drone deliveries a reality. Drone use has also become invaluable to various industries, such as real estate, where sellers can showcase their properties by providing an aerial view of the home and surrounding area. Additionally, drones have delivered medical supplies to rural areas surrounded by rough terrain. *See* Watch the First FAA-approved Delivery Drone Drop Medicine Down to Rural Virginians (2015), http://www.theverge.com/2015/7/20/9002639/first-legal-faa-approved-drone-delivery. As the technology advances, more uses for drones will inevitably be created.

While the technology and uses surrounding drones is rapidly evolving, the law has reacted more slowly. Still, legal issues have already begun to brew regarding various aspects of drone use. On July 21, 2015, it was reported that a teenager could be in trouble with the FAA after posting a video online that showed several shots being fired from a drone rigged to carry a handgun. Additionally, popular television show Modern Family aired a comical episode on March 4, 2015, highlighting a very real problem facing recreational drone use – invasion of privacy considerations. Questions have arisen regarding the delineation between private property lines and public airspace, an issue that is currently the subject of litigation around the country. *See e.g. Elec. Privacy Info. Ctr. v. Fed. Aviation Admin*, 821 F.3d 39 (D.C. Cir. 2016).

Most drones are classified as "unmanned aircraft systems" (UAS), which the FAA defines as an "unmanned aircraft and the equipment necessary for the safe and efficient operation of that aircraft." *See* Unmanned Aircraft Systems (UAS) Frequently Asked Questions (2016), https://www.faa.gov/uas/faqs/. The FAA further defines "unmanned aircraft" as "an aircraft that is operated without the possibility of direct human intervention from within or on the aircraft." *Id.* Many question whether a drone is the same as a model aircraft. To attempt to answer this question, Congress has defined "model aircraft" as a UAS that is: (1) capable of sustained flight in the atmosphere; (2) flown within visual line-of-sight of the operator; and (3) flown for hobby or recreational purposes. *Id.*

Recently, numerous rules and proposals have been considered regarding drone use. Since December 21, 2015, all owners of UAS which weigh between 0.55 and 55 pounds are required to register online to receive a Certificate of Aircraft Registration/Proof of Ownership for their drone or model aircraft. *See* 14 C.F.R. § 48 (2015). As part of the registration, each UAS used exclusively for recreation will be assigned a unique identification number that must be affixed to the drone prior to flying. *Id.* Failure to register a UAS can result in stiff penalties and fines. Furthermore, on August 29, 2016, new rules became effective regarding the use of UAS for both commercial and recreational use. *See* 14 C.F.R. § 107 (2016). At the state level, at least 38 states considered legislation related to UAS in the 2016 legislative season. *See* Current Unmanned Aircraft State Law Landscape (2016), http://www.ncsl.org/research/transportation/current-unmanned-aircraft-state-law-landscape.aspx. In Georgia, H.B. 779 passed in both the House and the Senate, only to be vetoed by Governor Deal. *See* H.B. 779, 153rd Cong. (2016) (vetoed). The bill sought to ban weaponized drones and create a drone commission to focus on economic benefits and development along with privacy and safety concerns. Deal stated the FAA should finalize federal rules and regulations regarding the use of drones before the state instituted regulations that could ultimately turn out to be contradictory to the federal rules. *See* Deal Issues 2016 Veto Statements (May 3, 2016), https://gov.georgia.gov/press-releases/2016-05-03/deal-issues-2016-veto-statements.

Drone use also creates uncertainty in the insurance arena. The uncertainty largely revolves around the classification of a drone and the specific language included in the policy.

Homeowners Insurance

A typical homeowners policy provides coverage for a claim or suit brought against an insured for "damages because of bodily injury or property damage" that is "caused by an occurrence." It is easy to imagine potential claims involving an accidental crash landing drone causing property damage or an overzealous drone pilot striking an unsuspecting friend causing bodily injury. Claims for property damage and bodily injury resulting from drone use would likely be covered under the general provisions of a homeowners policy.

However, it is less clear whether policies will provide coverage for an invasion of privacy claim. What qualifies as an "occurrence" will vary from policy to policy, but most homeowners policies exclude losses that arise out of the "ownership, maintenance, operation, use, loading or unloading" of any "aircraft." As such, the definition

of "aircraft" becomes the focus of any coverage opinion. In a recent declaratory judgment action, *Tucker v. Allstate Texas Lloyds Ins. Co.*, 180 S.W.3d 880 (2005), the policy defined "aircraft" as: a "device used or designed for flight, *except* model or hobby aircraft not used or designed to carry people or cargo." Under this definition, ambiguity arises as to whether a drone qualifies as an "aircraft." While all drones are designed and used for flight, not all are large enough or used to carry cargo.

Courts often accept evidence of common usage or even dictionary definitions to determine the meaning of a word, especially in cases of ambiguity. Merriam-Webster's dictionary defines "aircraft" as "a machine that flies through the air." http://www.merriam-webster.com/dictionary/aircraft. "Aircraft" may also be defined as "any machine supported by flight in the air by buoyancy or by the dynamic action of air on its surfaces, especially powered airplanes, gliders, and helicopters." Recently, the National Transportation Safety Board (NTSB) determined a drone is an "aircraft" for purposes of FAA enforcement of reckless operations. *See Huerta v. Pirker*, Order No. EA-5730, (NTSB Nov. 18, 2014). Therefore, the specific language defining "aircraft" in the policy is extremely important because, if properly worded, the definition can potentially limit claims for property damage and bodily injury resulting from drone use. Absent such definitions, there may be ambiguities regarding whether damage by drone is a covered cause of loss under the policy, and ambiguities in an insurance policy are almost always construed against the insurer. Of course, this would not include any claims related to a drone used for commercial use, since any business-related activities are typically excluded under a homeowners policy.

Commercial General Liability Insurance

As previously stated, commercial use of UAS is burgeoning. Governments have long used UAS for surveillance and national defense. UAS are also used for disaster relief, law enforcement and agricultural and environmental monitoring. Commercial use is spreading so quickly the Association for Unmanned Vehicle Systems International estimates that over 100,000 jobs will be created in this growing industry by 2025. *See* Daryl Jenkins and Dr. Bijan Vasigh, The Economic Impact of Unmanned Aircraft Systems Integration in the United States, https://higherlogicdownload.s3.amazonaws.com/AUVSI/958c920a-7f9b-4ad2-9807-f9a4e95d1ef1/UploadedImages/New_Economic%20Report%202013%20Full.pdf.

Commercial general liability policies typically provide coverage for "bodily injury" or "property damage" caused by an "occurrence," as well as for "personal and advertising injury." Similar issues arise interpreting the air craft exclusion contained in commercial general liability policies as those discussed above with respect to homeowners policies. Despite this, there are often other considerations arising from a commercial UAS claim that can provide defenses under the policy, such as the Expected or Intended Injury Exclusion and the Employer's Liability Exclusion. As commercial UAS use becomes more widespread in the day-to-day operations of industry, insurers will be faced with unique claims and coverage considerations under their GGL policies.

Many cases are currently in litigation regarding the use of UAS. *See Boggs v. Merideth*, 3:16-CV-6-DJH (W.D. Ky. Jan. 4, 2016). As the legal landscape is formed, insurers will need to be diligent in monitoring changes in state and federal regulations regarding UAS. In response to the rapid evolution of the industry, the Insurance Services Office (ISO) has developed several new optional exclusions and limited coverage endorsements to help address potential claims regarding UAS use. *See* ISO Drone Insurance Coverage Options Now Available to Insurers (2015), http://www.insurancejournal.com/news/national/2015/06/03/370433.htm. With the recent revisions to the FAA's regulations on UAS, it is likely that even more new issues will arise for insurers. As such, insurers will need to be proactive in reviewing their policies and considering how coverage issues will be determined under both homeowners and commercial liability policies. With the ever-changing state of the industry, insurers need to commit to staying informed, being proactive and keeping an eye on the sky.

For more information on this topic, contact Kori Eskridge at kori.eskridge@swiftcurrie.com or 404.888.6191. ■

"Business-Risk Exclusions" Expanded to Include General Contractors

By: Alex A. Mikhalevsky

Almost every commercial general liability (CGL) policy contains a series of exclusions known as the "business-risk exclusions." Generally, these exclusions preclude coverage for any first-party

2015 Alabama Insurance Case Law Review

By: Brian C. Richardson

As the Birmingham Office of Swift Currie has recently reached its one-year anniversary, we wanted to reflect on some recent developments in Insurance Law in Alabama. Alabama is home to numerous laws that are unique to our state. For instance, unlike most states, Alabama is a contributory negligence state; meaning, a plaintiff's own negligence can be a complete bar to recovery in civil litigation. Below we discuss some recent decisions from Courts in Alabama.

***Harvey v. Acceptance Indem. Ins. Co.*, 2016 WL 3963041 (S.D. Ala. July 20, 2016)**. In *Harvey v. Acceptance Indem. Ins. Co.*, the District Court for the Southern District of Alabama applied the "Assault and Battery Exclusion" contained in a commercial general liability policy to a claim arising from a gunfight that broke out after a night of drinking at the Paradise Lounge outside of Mobile, Alabama. More specifically, the Court held the exclusion applied to all coverage parts of the policy, including the liquor liability coverage because: (1) the Policy's declarations showed that the exclusion applied to all coverages; and (2) the language in the exclusion itself did not limit its application to only certain parts of the policy. The plaintiffs, who were the relatives of two individuals killed in the gunfight, obtained a verdict of $500,000 each from the Paradise Lounge in a civil action filed in state court. The plaintiffs then filed suit directly against the CGL carrier for Paradise Lounge to collect the judgment pursuant to Section 27-33-2 (1975) of the *Code of Alabama*. The carrier moved for summary judgment based on the "Assault and Battery Exclusion," which the Court granted. According to the Court, the clear and unambiguous language of the exclusion applied to all parts of the Policy, including Liquor Liability. Thus, there was no coverage for the plaintiffs' claims, even though the plaintiffs' obtained a judgment against Paradise Lounge in the State Court action.

***Ex parte FCCI Ins.*, Ala. Sup. Ct. Case No. 1150230 (July 8, 2016)**. In a "no opinion" order, the Supreme Court refused to issue a *writ of mandamus* directing the State Circuit Court to dismiss a declaratory action filed by the insured subsequent to the filing of a federal court declaratory action filed by the insurer. The decision contradicted prior precedent. Specifically, in *Ex parte Canal Ins. Co.*, 534 So. 2d 582 (Ala. 1988) and *Ex parte Brooks Ins. Agency*, 125 So. 3d 706 (Ala. 2013), the Court held that an earlier-filed declaratory judgment action required dismissal of the later-filed case pursuant to Alabama's abatement statute, Section 6-5-440 (1975) of the *Code of Alabama*. However, without explanation, the Alabama Supreme Court refused to follow this general rule, suggesting the application of Alabama's abatement statute requires a more nuanced evaluation and consideration.

***Har-Mar Collisions, Inc. v. Scottsdale Ins. Co.*, 2016 WL 3136189 (Ala. 2016)**. As a matter of first impression, the Supreme Court of Alabama reformed an insurance policy to name the correct corporate entity as the insured where the policy identified the named insured as "Harmar, Inc.," and the correct corporate entity was "Har-Mar Collisions, Inc. d/b/a Marshall Paint & Collision." The entity "Harmar, Inc." did not exist.

The insured operated an automobile repair shop under the d/b/a of Marshall Paint and Collision. Marshall Paint and Collision was the d/b/a of Har-Mar Collisions, Inc., which owned the business. The independent insurance agency procured a policy for property coverage for the business from Scottsdale Insurance Company and indicated the named insured should be identified as "Harmar, Inc." Thus, the policy was issued to the named insured "Harmar, Inc." A fire loss occurred to the automobile repair shop and Har-Mar Collisions, Inc. initiated a claim for its lost business income and other damage due to the fire. Scottsdale Insurance Company inquired as to the relationship between Harmar, Inc. and Har-Mar Collisions, Inc., and refused to make any payments under the policy until the relationship between the corporate entities was clarified. Har-Mar Collisions sued Scottsdale seeking a declaratory judgment that the named insured under the policy was Har-Mar Collisions, Inc.

In response, Scottsdale asserted that Har-Mar Collisions, Inc. lacked standing to maintain its action against Scottsdale since it was not a party to the insurance contract.

The primary issue in the litigation was whether the policy should be reformed to name the correct corporate entity as the named insured. At trial, the jury found in favor of Har-Mar Collisions, Inc. and entered a verdict of approximately $101,000. Subsequently, the court set-off the damages awarded to Har-Mar Collisions, Inc. in the amount of previous settlement agreements reached between Har-Mar Collisions, Inc. and other defendants.

Both parties appealed. Scottsdale Insurance Company argued reformation of the policy to name Har-Mar Collisions, Inc. as the named insured was improper. Under Alabama law, reformation is permitted when, "through fraud, a mutual mistake of the parties, or mistake of one party which the other at the time suspected," a written contract does not represent the mutual intent of the parties and reformation can be completed without prejudice to the rights acquired by third persons in good faith and for value. The party seeking to reform the contract must show by clear and convincing evidence that all of the requirements to reform the contract have been met. Since the issue of reformation had not been previously addressed by Alabama courts, the Court relied on an analysis provided by the Court of Appeals of Ohio. In that case, the Ohio court considered what each party intended to insure as a basis for determining whether sufficient mutual mistake existed to permit reformation of the contract. If both parties intended to insure the same substantive entity, then mutual mistake would permit reformation of the contract to name the correct formal legal entity.

In the instant case, the Court defined mistake as a "belief that is not in accord with the facts." Since both Scottsdale and Har-Mar Collisions, Inc. intended to insure the automotive repair shop doing business as Marshall Paint and Collision, the failure to name the correct corporate entity on the policy was the result of mutual mistake, particularly since the insured named was a nonexistent entity. Notably, the Court rejected Scottsdale's argument that it did not make a mistake since it issued the policy in accordance with the name listed on the insurance application. According to the Court, both parties believed that the policy, as written, provided coverage to the auto repair while the facts indicated the opposite. Therefore, even though there may have been a unilateral mistake on the part of Har-Mar Collisions, Inc. and its agents by listing the wrong corporate entity on the insurance application, mutual mistake still existed as to the subject of the insurance policy. Therefore, the Court held there was clear and convincing evidence the parties intended the policy to insure the auto shop and that the parties had a mutual misunderstanding that the policy, as written, did so. Thus, reformation based on mutual mistake was appropriate and the named insured under the Policy should be changed to the proper corporate entity.

In addition, the Court determined the set-off of the judgment in favor of Har-Mar Collisions, Inc. was inappropriate. Under Alabama law, a defendant is not entitled to a set-off of a judgment entered against it based on the settlement between a plaintiff and another defendant if the two defendants owe separate and distinct contractual or other obligations to the plaintiff. Here, one insurance carrier that reached a settlement agreement with the plaintiff provided liability insurance to Har-Mar Collisions, Inc., which was separate and distinct from the property coverage afforded by Scottsdale. The other defendant who reached an agreement with the plaintiff prior to trial was the independent insurance agent who undertook no obligation to insure the plaintiff under any circumstances. Therefore, these obligations were separate and distinct from the obligations of Scottsdale Insurance Company and Scottsdale was not entitled to a set-off of any judgment entered against it.

In light of the foregoing, the Court affirmed the trial court's reformation of the insurance policy to name the correct corporate entity and reversed the trial court's determination to set-off the amount of the jury verdict in the amount of the settlement agreements reached by Har-Mar Collisions, Inc. prior to trial.

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claim for damage to the insured's own work. However, the business -risk exclusions will not preclude coverage when the insured's own work causes damage to property not included within the insured's scope of work.

For example, consider a contractor insured by a standard CGL policy who is hired to install a brick chimney on a house. One month after the chimney is completed, the chimney collapses due to the contractor's poor workmanship. When the chimney collapses it does not cause damage to any other property, but the chimney itself is destroyed. The contractor files a claim under the contractor's CGL policy seeking coverage for the cost to rebuild the chimney. The business-risk exclusions in the contractor's CGL policy would exclude coverage as the damage was to the contractor's own work, i.e. the chimney. If instead, the chimney collapses, striking and damaging a wooden deck under construction in the same house (but by another contractor), the exclusions would not preclude coverage for damage to the deck.

Thus, when a contractor seeks first-party coverage under its own CGL policy, a court will look to the contractor's scope of work to determine if the damage was to the insured's own work and, therefore, precluded by the business risk exclusions. This same analysis applies for a subcontractor seeking first-party coverage under its own CGL policy.

In 2015, however, the Georgia Court of Appeals evaluated which "scope of work" should be considered when a general contractor makes a claim as an additional insured under a sub-contractor's CGL policy. Should the court consider the additional insured's, i.e. the general contractor's, scope of work, or should the court consider the named insured's, i.e. the subcontractor's, scope of work in determining whether the business risk exclusions applied?

In *Auto-Owners v. Gay Construction Co.*, 332 Ga. App. 757, 774 S.E.2d 798 (2015), Piedmont Park Conservancy hired a general contractor, Gay Construction Co. (GCC), to construct a swimming pool and associated buildings for Piedmont Park. In connection with the work, Gay Construction hired a sub-contractor, who then hired another sub-contractor, Dai-Cole Waterproofing Company, Inc. (Dai-Cole), to install a waterproofing and drainage system in a terrace located over a building that was also constructed as part the project. *Id.* at 758, 774 S.E.2d at 799.

Within a few months after GCC completed the project, Piedmont Park complained about a water leak in the terrace and damage to the building beneath it. GCC investigated and determined the leak was caused by improper installation of the waterproofing material by Dai-Cole. Dai-Cole refused to make repairs. GCC performed the repairs which included removal and replacement of the concrete terrace and the associated waterproofing material, for a total cost of over $126,000.00. Thereafter, GCC filed a first-party claim for the cost of the repairs as an additional insured under the CGL policy issued to Dai-Cole by Auto-Owners. *Id.*

Auto-Owners denied coverage citing the business-risk exclusions, and GCC filed suit against Auto-Owners for breach of contract and bad faith. The trial court denied Auto-Owners' Motion for Summary Judgment and Auto-Owners appealed the decision to the Georgia Court of Appeals. *Id.* at 757, 774 S.E.2d at 798.

To resolve the coverage question under the Auto-Owner's policy, the Court considered whether it should rely on the general contractor's scope of work or if it should rely upon the sub-contractor's scope of work when analyzing the applicability of business-risk exclusions for a claim filed by a general contractor named as an additional insured under a sub-contractor's CGL policy?

Ultimately, the Court determined the general contractor's scope of work, which is much broader than the sub-contractor's scope, should apply. As GCC's scope of work encompassed both the construction of the terrace and the building under the terrace, the Court found the damage was to GCC's work, even though the waterproofing was actually installed by Dai-Cole. Therefore, the business-risk exclusions applied and there was no coverage under Dai-Cole's CGL policy for the repairs to the terrace.

The Court reasoned that allowing GCC to recover under the policy would be tantamount to extending more coverage to an additional insured than the policy afforded its named insured. Further, allowing recovery to GCC would force Auto-Owners to financially guarantee its insured's work, which is not the purpose of CGL coverage.

How Does this Impact Insurers?

The Court's holding in *Auto-Owners v. Gay Construction Co.* has expanded the reach of the business-risk exclusions to include, at least to some extent, additional insureds under CGL policies. Although the breadth of this expansion is unclear, it is clear that general contractors will be unable to recover as additional insureds under a subcontractor's insurance policy for damage caused by poor or faulty work in areas included within the general contractor's scope of work set forth in the master contract. Similarly, this principle will likely apply to any subcontractors who retain a second subcontractor and who seek coverage as an additional insured under the second subcontractor's GCL policy for faulty work performed by the second subcontractor.

For more information on this topic, contact Alex Mikhalevsky at alex.mikhalevsky@swiftcurrie.com or 404.888.6154.

Events

WORKERS' COMPENSATION WEBINAR: Federal Rules of Civil Procedure "Don't Get Board: Fun With Forms Deadlines and Board Forms in the Life of a WC Claim
Wednesday, December 14, 2016
1:00 - 2:00 pm EST

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