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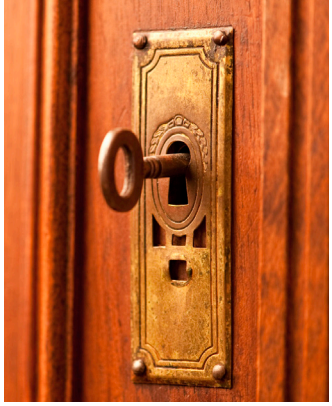

The 1st Party Report

A Property & Insurance Update

Fall 2017

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Insurers in Hot Water Over Recent Opinion Interpreting an Absolute Pollution Exclusion

By: Brian C. Richardson

There is hardly a more contested and litigated exception to an insurance policy than that of the pollution exclusion. Over the past 50 years, pollution exclusions have evolved from exclusions limited to industrial and environmental pollution (qualified pollution exclusions) to the modern and far broader pollution exclusions that exclude coverage for property damage and bodily injury arising from pollution "at any time," "regardless of the cause" (absolute and total pollution exclusions). Although a majority of courts across the country have found the absolute and total pollution exclusions "bar coverage for all types of pollution claims," inconsistent interpretations of these exclusions and results-driven outcomes create uncertainty and chaos for underwriters and insurers. *See, e.g., Kruger Commodities, Inc. v. U.S. Fid. & Guar.*, 923 F. Supp. 1474 (M.D. Ala. 1996). Fifteen years ago, Justice Harwood of the Alabama Supreme Court summed up the status of the law best when he wrote:

> Our review and analysis of the entire body of existing precedent reveals that there exists not just a split of authority, but an absolute fragmentation of authority [regarding pollution exclusions]. Cases may be found for and against every issue any litigant has ever raised, and often the cases reaching the same conclusion as to a particular issue do so on the basis of differing, and sometimes inconsistent, rationales.

Porterfield v. Audubon Indem. Co., 856 So. 2d 789 (Ala. 2002). Fifteen years later, this statement remains true.

A recent opinion from the Washington Supreme Court held that an absolute pollution exclusion does not negate liability coverage where negligence is the primary cause of the loss. Even though the justices concluded carbon monoxide was a pollutant, the damages clearly were caused by the pollutant, and the absolute pollution exclusion applied, the "efficient proximate cause" rule required coverage. Previously, the efficient proximate cause rule has only been applied to first party insurance policies. Even more troubling, despite no precedent for the application of this rule to a liability policy, the Court held the insurer's refusal to defend was in bad faith because the insurer failed to recognize the possibility that a covered negligent act was the predominant cause of the injuries.

The opinion arises from *Xia v. ProBuilders Specialty Ins. Co.*, Case No. 92436-8 in the Supreme Court of the State of Washington. The homeowner, Zhaoyun Xia, sued ProBuilders' policyholder over injuries stemming from toxic levels of carbon monoxide released from a hot water heater. ProBuilders refused to defend the policyholder, who installed a water heater in Xia's home, on the basis that the absolute pollution exclusion barred coverage. The pollution exclusion provided as follows:

> Bodily injury, property damage, or personal injury caused by, resulting from, attributable to, contributed to, or aggravated by the actual alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants, or from the presence of, or exposure to, pollution of any form whatsoever, and regardless of the cause of the pollution or pollutants.
>
> This Exclusion applies regardless of the cause of the pollution and whether any other cause of said bodily injury, property damage, or personal injury acted jointly, concurrently, or in any sequence with said pollutants or pollution. This Exclusion applies whether any other cause of the bodily injury, property damage, or personal injury would otherwise be covered under this insurance.

Xia settled with the policyholder who assigned its rights under ProBuilders' policy to Xia. Xia then sued ProBuilders for bad faith, breach of contract, and violations of Washington's Consumer Protection Act and Insurance Fair Conduct Act. ProBuilders prevailed on summary judgment and a state appellate panel affirmed the summary judgment. Xia appealed to the Washington Supreme Court.

Six of the nine justices concluded that although carbon monoxide clearly falls within the absolute pollution exclusion in a liability policy, coverage is still available for the underlying suit brought by Xia ***because the predominant cause of the injury was the policyholder's negligent installation of the water heater***. The majority held that while a "polluting occurrence" obviously happened when the water heater spewed toxic levels of carbon monoxide into Xia's home, it is "equally clear" that ProBuilders' policy still provides coverage under Washington's "efficient proximate cause" rule. The Court further found ProBuilders' refusal to defend was in bad faith because it failed to recognize the possibility that a covered negligent act was the predominant cause of Xia's injuries.

Washington's "efficient proximate cause" rule is typically limited to first-party property insurance cases and states that coverage exists if a covered risk sets in motion a chain of events leading to an injury even if an excluded risk is part of the chain. In other words, "if the initial event, the 'efficient proximate cause,' is a covered peril, then there is coverage under the policy regardless of whether subsequent events within the chain, which may be causes-in-fact of the loss, are excluded by the policy." *Xia*, Case No. 92436-8, p.13. The opinion states "[u]nder these facts, Probuilders . . . correctly identified the existence of an excluded polluting occurrence under the unambiguous language of the policy. However, it ignored the existence of a covered occurrence, negligent installation, that was the efficient proximate cause of the claimed loss." *Xia*, Case No. 92436-8, p.2-3. "The polluting occurrence here happened only after an initial covered occurrence, which was the negligent installation of a hot water heater that typically does not pollute when used as intended." *Id.* at 11.

This holding creates anxiety and confusion for those attempting to apply this law. In essence, this result renders total and absolute pollution exclusions in the state of Washington, and any state that would apply this holding, meaningless because many pollution incidents are caused by negligence. In other words, a claim against a policyholder need only contain certain allegations suggesting that negligence may have played a part in a loss to trigger an insurer's duty to defend. Although *Xia* applies Washington state law, courts in Georgia and Alabama can rely on this case as persuasive authority when interpreting an undeveloped area of law. Thus, insurers here will be well served to monitor recent developments in the application of pollution exclusions especially when dealing with a similar pollutant.

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A New Twist on Judicial Estoppel

By: Kori E. Eskridge

The doctrine of judicial estoppel is designed to protect the integrity of the judicial system by "preventing parties from asserting positions inconsistent with ones successfully asserted by the same party in a prior proceeding." *S.J. Groves & Sons Co. v. Fulton Co.*, 967 F. Supp. 501, 502 (N. Ga. 1996). Georgia courts have long held that judicial estoppel may be applied when a two-part test has been satisfied. Specifically, judicial estoppel is applicable in matters where: (1) a plaintiff took a position under oath in a bankruptcy proceeding that was inconsistent with the plaintiff's pursuit of the civil lawsuit, and (2) the plaintiff intended to make a mockery of the judicial system. *Morton v. Bank of Am. Corp.*, 2012 U.S. Dist. LEXIS 127389 (M.D. Ga. 2012).

The Eleventh Circuit recently revisited and clarified the second prong of this test in *Slater v. U.S. Steel Corp.*, 2017 U.S. App. LEXIS 17994 (11th Cir. 2017). In *Slater*, the Eleventh Circuit reaffirmed precedent that when a plaintiff takes inconsistent positions by pursuing in district court a civil claim he failed to disclose as an asset in his bankruptcy proceedings, judicial estoppel can be applied if the plaintiff "intended to make a mockery of the judicial system." The Court also expanded the analysis district courts should use when considering whether the second prong of this test is met.

Previously, federal district courts could infer that the plaintiff intended to misuse the judicial system based solely on the fact that the plaintiff omitted information. In both *Barger v. City of Cartersville*, 348 F.3d 1289 (11th Cir. 2003) and *Burnes v. Pemco Aeroplex, Inc.*, 291 F.3d 1282 (11th Cir. 2002), an inference was drawn that a plaintiff who failed to disclose a lawsuit in a Chapter 7 bankruptcy

No Good Deed Goes Unpunished: Is an Insurer Ever Liable for Negligent Repairs?

By: Rebecca E. Strickland

When an insured homeowner has a covered loss, the insurer generally elects to pay the claim, rather than perform the repairs. When an insurer pays a claim, it has no duty to ensure the repairs are performed properly. In fact, most homeowners policies exclude coverage for negligent repair work performed after a covered loss. However, if an insurer elects to repair the property instead of paying the loss, it must ensure the repair work is performed properly and in a workmanlike manner.

In *Carter v. Allstate Ins. Co.*, 197 Ga. App. 738, 399 S.E.2d 500 (1990), the insureds suffered a small fire which caused damage to their home. The insureds received a call from a contractor recommended by their insurer. The insureds were told the contractor was authorized to perform the clean-up, and Allstate then paid the contractor directly. Later, the same contractor informed Allstate that it wanted to perform the structural repair work. Allstate agreed the contractor could do the work if the insureds agreed. During the repairs, a subcontractor hired by the contractor ground adhesive off the back of some of the insureds' vinyl flooring, releasing asbestos dust into the house, requiring significant clean-up and remediation. The *Carter* Court found that a triable fact issue existed as to who hired the contractor. If Allstate hired or chose the contractor, then it had implicitly made an agreement to repair the damage. As such, if the repairs were not performed properly, Allstate could be liable for the unsatisfactory repair work.

The Georgia Court of Appeals recently decided a similar decision. In *Clary v. Allstate Fire & Cas. Ins. Co.*, 340 Ga. App. 351, 795 S.E.2d 757 (2017), lightning struck the insureds' house, causing a fire. The policy provided that Allstate could elect either to perform the repairs or pay for the necessary repairs. The insureds contended that Allstate hired contractors to perform the repairs and, thus, elected to perform the repairs. A dispute arose regarding the work necessary to remediate mold that was related to the loss. The dispute was resolved through the policy's appraisal process. Allstate attempted to pay the appraisal award, but the insureds initially rejected the payment arguing the appraisal was invalid because Allstate had elected to repair the property. The insureds argued that once Allstate elected to repair the property, the costs to repair the damage were immaterial. The Court disagreed with the insureds and reiterated the holding in *Carter*. The Court explained that if an insurer elects to repair a home, it must restore the property to its pre-loss condition and ensure the repairs are performed in a skillful and workmanlike manner. Even if the repairs are performed properly, the insurer may be required to compensate the insured for any diminution in value.

The *Clary* Court also disagreed with the insureds' argument that once an insurer elects to repair a property, it may not later elect to pay the amount of the damage. The insureds argued that Allstate formed a new agreement by electing to repair the property. According to the insureds, this alleged new agreement required Allstate to restore the property to a habitable condition. Since Allstate ceased repairs and sought appraisal, the insureds argued that Allstate breached the agreement. The Court held that on the facts of this case, Allstate could not create an *implied* contract because the *express* contract, the policy, gave Allstate the right to choose between making the repairs and paying the claim. The Court held there was no implied contractual duty for the insurer to perform.

Where does this leave an insurer? If an insurer hires a contractor to perform repairs, then the insurer will likely be responsible for ensuring that the repairs are performed in a workmanlike manner. As illustrated in *Carter*, the identity of the party who hired the contractor may be a triable factual issue. Thus, the insurer should take care to avoid any appearance that it hired or controlled the contractor.

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intended to manipulate the judicial system because the omission was not inadvertent. This reasoning was also extended to cases involving Chapter 13 debtors as well. *See, Robinson v. Tyson Foods, Inc.*, 595 F.3d 1269, 1275-76 (11th Cir. 2010) and *De Leon v. Comcar Indus., Inc.*, 321 F.3d 1289, 1291-92 (11th Cir. 2003). As such, the omission alone was sufficient for the court to make a determination that the debtor intended to misuse the judicial system, even without considering additional facts.

In clarifying this portion of the two-part test, the *Slater* Court determined the district court is required to consider all the facts and circumstances of the case, including, but not limited to, the plaintiff's level of sophistication, his explanation for the omission, whether and under what circumstances he subsequently corrected the disclosures, whether the trustee or creditors were aware of the civil lawsuit or claim before the plaintiff amended the disclosures, and any action taken by the bankruptcy court concerning the nondisclosure. The court emphasized that this list was not exhaustive; instead, the district court was free to consider any fact or factor it deemed relevant to the inquiry.

Notably, the court found "voluntariness alone does not necessarily establish a calculated attempt to undermine the judicial process." The court explicitly overruled portions of *Barger* and *Burnes*, to the extent that they permitted a district court to infer intent to misuse the courts without considering the individual plaintiff and the circumstances surrounding the nondisclosure. Specifically, the court held that it was necessary to consider both the plaintiff's actions and his motive to determine whether the second prong of the test was met. The court found that further inquiry would ensure the district court would be allowed to consider any proceedings that occurred in the bankruptcy court after the omission was discovered and would ensure the doctrine was applied only when a party acted with a "sufficiently culpable mental state." Finally, the court reasoned that the expanded test was more consistent with the equitable principles of the judicial estoppel doctrine.

In first party cases, it is not uncommon to handle theft or arson claims filed by insureds that have previously filed for bankruptcy. In such cases, an insured typically submits a personal property inventory listing the items claimed to have been damaged in the insurance loss. Similarly, in bankruptcy proceedings, debtors are often required to list the value of their personal property on the bankruptcy petition. When there is a short amount of time between the bankruptcy and the loss, it can be advantageous to obtain as much information about the bankruptcy proceeding as possible. This information, coupled with other information about the insured's financial condition during that time period, the type of items claimed, and the insured's insurable interest in the claimed items, can help adjusters determine whether judicial estoppel may be asserted. Furthermore, it is important to determine the status of the bankruptcy, such as whether it has been discharged, as this will also affect the applicability of judicial estoppel.

Although judicial estoppel is only applicable once litigation has been initiated, it can influence the coverage analysis, and, ultimately, the insurer's decision on the claim. By asking the right questions and obtaining relevant information during the investigation of the claim, the insurer will be in a better position to evaluate potential coverage issues, if any, regarding an insured's personal property claim.

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Events

"Scrap the App...We Have an Attorney for That!" — Annual Property, Coverage and Casualty Insurance Litigation Client Seminar
Friday, November 3
Cobb Energy Performing Arts Centre
8:45 am - 3:30 pm

Many Swift Currie programs offer CE hours for insurance adjusters. To confirm the number of hours offered, for more information on these programs, or to RSVP, visit www.swiftcurrie.com/events.

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