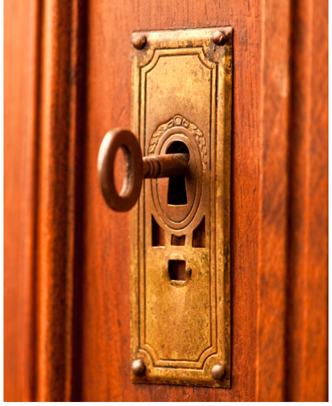

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The 1st Party Report

A Property & Insurance Update

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Ga. Supreme Court Clarifies Meaning of "Occurrence" in CGL Policy Two Years After *Hathaway*

By: Thomas B. Ward

Two years ago in the much publicized case *American Surplus v. Hathaway*, the Georgia Supreme Court clarified a previously murky area of insurance law by holding that a construction defect may constitute an "occurrence" under a commercial general liability (CGL) insurance policy. *See American Empire Surplus Lines Insurance Co. v. Hathaway Dev. Co.*, 301 Ga. App. 65, 707 S.E.2d 369 (2011). But the language of that opinion led some to question whether the term "occurrence" necessarily required damage to property other than the insured's own work.

Thus, the Georgia Supreme Court recently revisited the meaning of "occurrence" under CGL policies in *Taylor Morrison Services, Inc. v. HDI-Gerling America Insurance Company*, No. S13Q0462 (Ga. July 12, 2013), in an important opinion whose impact on coverage law extends beyond the confines of construction defect claims.

The coverage dispute arose out of an underlying lawsuit brought by several homeowners against home builder Taylor Morrison for allegedly failing to properly construct slab foundations. Taylor Morrison's insurer, HDI-Gerling America Insurance Company, initially defended the underlying action and sought to extinguish its duty to defend and indemnify Taylor Morrison by seeking a declaratory judgment in federal court. HDI-Gerling argued the defectively constructed house slabs could not constitute an occurrence under the policy because the property damage was limited to the insured's completed work—the slabs—instead of damage to other property not constructed by the insured.

Answering a certified question, the Georgia Supreme Court clarified that a construction defect claim constitutes an "occurrence" even when the only damage alleged is the work of the insured contractor. In addressing whether the insured's own defective construction can be an "occurrence," the Court focused on the plain meaning of the policy. The policy defined "occurrence" as an "accident." Because "accident" was undefined, the Court looked to its most commonly accepted meaning and commented that the term accident does not usually and commonly convey information about the nature or extent of injuries resulting from an accident or the identity of the person whose property was damaged. Thus, the Court held the term "occurrence" only requires the accidental property damage and does not impose the further requirement of damage to the property or work of someone other than the insured.

Importantly, the Court clarified that its holding was consistent with the settled notion that CGL coverage is intended to insure against liabilities to third parties for injury to property or person, but not to insure mere liabilities for the repair or correction of faulty workmanship of the insured. Coverage in faulty workmanship cases is still limited to situations in which the faulty workmanship has damaged other, nondefective property or work. But instead of relying on the term "occurrence" to narrow coverage accordingly, the Court stated that other portions of the policy are better suited for that purpose. Specifically, the Court noted the standard CGL policy requires "property damage," a term that "necessarily must refer to property that is nondefective, and to damage beyond mere faulty workmanship. The Court also noted that applicable exclusions, such as the business risk exclusions, also may serve to exclude liabilities for the repair or correction of defective work.

The Court also addressed whether the term "occurrence" dictates that the liabilities for which coverage is claimed must be based on some legal theory other than fraud or breach of warranty, such as negligence. The Court again focused on how the Policy defines an "occurrence" as an "accident." In doing so, the Court determined that to the extent a theory of liability is absolutely and necessarily inconsistent with the notion of an accident—that is, when the theory of liability and the idea of an accident are mutually exclusive—a claim premised upon such a theory of liability could not possibly involve an occurrence." Thus, because fraud is based on intentional conduct, it is necessarily inconsistent with the concept of an accident and could not involve an occurrence. On the other hand, the Court found a warranty can be breached accidently and could constitute an occurrence.

This decision will ultimately have far-reaching application apart from just the construction defect context because it serves as a roadmap for analyzing liability coverage generally. The main takeaway is found in the Court's concluding admonishment that "permitting each requirement of the insuring agreement and exclusion to serve its own purpose is a sounder analytical approach than any endeavor to make 'occurrence' bear the entire burden for defining the limits of coverage."

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Reservations Strongly Recommended

By: Elizabeth J. Satterfield

In *Hoover v. Maxum Indemnity Co.*, the Georgia Supreme Court ruled that a liability insurer cannot both deny liability coverage and concurrently reserve its right to assert other coverage defenses later. 291 Ga. 402 (2012). Instead, the liability insurer must notify its insured of all possible defenses to coverage at the time of denial, or risk waiving those defenses in future coverage litigation. In *Hoover*, an employee suffered a serious brain injury and sued his employer. The employer's insurance company, Maxum Indemnity Company, denied coverage and refused to defend the employer based on the "employer's liability exclusion." The denial letter issued by Maxum to the employer specifically cited that exclusion and concluded with standard boilerplate language reserving the right to deny based on any later discovered defenses. After the insured employer was hit with a $16.4 million verdict, the insured assigned its claims against Maxum to the plaintiff and the plaintiff sued Maxum for bad faith refusal to defend and indemnify the insured. When it was held that the employer's liability exclusion did not apply, Maxum attempted to assert the late notice provision as an additional defense to coverage. The court held that the notice provision had been waived because it had not been raised in the denial letter. The Court rejected Maxum's reservation of rights on the basis that an insurance company cannot both deny coverage and reserve its rights to assert other defenses later. According to the Court, a liability insurer presented with a claim has three possible courses of action: (1) defend the claim against its insured, thereby waiving its policy defenses and claims of noncoverage; (2) defend its insured under a reservation of rights; or (3) deny coverage and refuse to defend its insured, leaving all explicitly raised policy defenses open for future litigation while waiving all unasserted defenses to coverage.

Hoover created a precedent for the idea that an insurer must itemize all defenses in its reservation of rights or risk waiver of those defenses. *Facility Investments v. Homeland Insurance*, extends the rationale of *Hoover*. 321 Ga. App. 103, 741 S.E. 2d 228 (2013). Facility Investments held $1 million in liability insurance with Homeland Insurance. Facility was sued for professional negligence in connection with care of a patient in its nursing home. Some of the facts and allegations in the Complaint fell within the intentional misconduct exclusion in Homeland's policy, so the defense was undertaken pursuant to a reservation of rights. The reservation of rights letter did not expressly reserve the contractual right to pursue claims for breach of contract, recoupment, allocation or

The Doctrine Has Left the Building(s): Georgia Clarifies Commercial Property Insurers' Subrogation Rights

By: Arthur R. York

Acme Explosives, Inc. submits a claim for property damage. You, Acme's insurer, process and pay the claim and proceed to exercise your subrogation rights. You assume all the accompanying duties and costs of litigation: time, investigation, discovery, consulting with counsel, hiring experts, and so forth. Then, on the brink of settlement, Acme slams on the brakes—they demand to have a voice in mediation, claiming they have the right to be "made whole" before you settle the subrogation claim with the tortfeasor. They threaten a bad faith action if you do not cave to their demands. You have tried to do everything you are supposed to each step of the way, but now find yourself in a tough spot. What are your options?

In this scenario, Acme is trying to borrow a page from personal injury law and rely on the "made whole" doctrine. In a typical negligence action, if an insurer (a healthcare insurer, for instance) pays the plaintiff benefits, the made whole doctrine prevents the insurer from pursuing subrogation from the tortfeasor until the plaintiff has been "made whole." Likewise, in worker's compensation, the claimant's complete compensation for disability benefits and medical expenses is a statutory prerequisite to the employer's or insurer's right to subrogate.

But does this rule apply to property damage cases? Georgia's highest court recently addressed whether the insured in a commercial property policy has a cause of action against its insurer when the insurer subrogates a property damage claim without first demonstrating that the insured has been made whole for the loss. *Woodcraft by MacDonald, Inc. v. Ga. Cas. & Sur. Co.*, 293 Ga. 9, 743 S.E.2d 373 (2013). In that case, the insured, Woodcraft, filed a claim under its commercial property policy after an underground gas pipeline exploded and damaged Woodcraft's building. Woodcraft's insurer, Georgia Casualty, paid Woodcraft $1,675,169 on the claim. Georgia Casualty then filed a subrogation action against Atmos Energy, the pipeline owner. Woodcraft joined the case as co-plaintiff to assert claims outside the coverage of its property insurance policy. After two years of litigation, Georgia Casualty settled with Atmos for $950,000. Woodcraft objected to the settlement, claiming Georgia Casualty was prohibited from settling the case until Woodcraft was "made whole" – i.e., recovered *all* contribution. During discovery, unfavorable facts developed that increased the risk of liability and gave rise to concerns about an award of punitive damages. Those same facts fell within the intentional misconduct exclusion.

The plaintiff made a 30-day demand for the policy limits. Three days before the deadline to respond, Facility demanded Homeland settle the case within the policy limits. Homeland responded that the policy's general conditions required Homeland and Facility to use their best efforts to allocate settlement between covered and uncovered claims, with Homeland paying for covered claims and Facility paying for uncovered claims. Further, Homeland stated for the first time that it would pursue recoupment/contribution in the event that Facility did not pay its share for the uncovered losses. In response, Facility notified Homeland that it would not contribute to a settlement, or otherwise allocate between covered and uncovered losses, because Homeland was obligated to settle the underlying suit on Facility's behalf.

Homeland issued a unilateral reservation of rights letter, citing the uncovered loss allocation condition and its right to seek recoupment for defense costs and settlement payments made on uncovered claims. Homeland then settled for the $1 million policy limit with one day remaining on the time-limited demand and later sued Facility for reimbursement of the settlement payments made toward uncovered claims.

The Court held that Homeland waived its right to pursue Facility for the uncovered settlement amounts when it made a settlement payment with knowledge of the circumstances giving rise to its coverage defenses. The Court noted that Homeland defended Facility in the underlying case, knowing the plaintiffs asserted claims for losses that were not covered under the Policy. Homeland undertook its defense subject to a reservation of rights, which specifically reserved referenced losses or defense expenses arising out of allegations of fraud. However, the initial reservation of rights letter did not provide Facility with any notice that Homeland intended to settle an uncovered claim and sue for reimbursement/contribution under the uncovered loss allocation provision. Further, the Court found the second reservation of rights letter, sent a day before settlement occurred, was ineffective because its reservation was rejected by Facility.

The Court based its holding on the specific facts of the case and incorporated the rationale first presented in *Hoover*. At the time Homeland sent its second reservation of rights letter, the claims of fraud were supported by evidence. When Facility refused to contribute to Homeland's proposed settlement of the underlying case, Homeland had only two options at that point: (1) deny coverage; or (2) seek immediate declaratory relief. Homeland, however, chose to defend and settle the underlying suit with knowledge of the uncovered claims, and without specifically reserving its rights with regard to the uncovered loss allocation provision. Since Homeland settled the case, rather than denying coverage or seeking declaratory judgment, Homeland waived any right to seek reimbursement for uncovered amounts of the settlement.

If an insurer develops other potential defenses to coverage, an initial reservation of rights letter may be amended to add other defenses. However, an insurer should be careful in drafting a reservation of rights to include any anticipated defenses, particularly defenses that relate to the allocation of settlement.

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damages from the loss, including those damages which were not covered under the policy. The trial court denied Woodcraft's objection and Woodcraft subsequently settled its own claims against Atmos for $125,000 for the non-covered losses. After both Woodcraft and Georgia Casualty settled their respective claims with Atmos, Woodcraft demanded an additional $179,130 from Georgia Casualty—an amount Woodcraft contended it was still owed in order to be made whole.

Georgia Casualty denied the demand and Woodcraft sued for bad faith and breach of contract. Georgia Casualty moved for summary judgment, which the trial court denied on the breach of contract claim but granted as to the bad faith claim. On appeal, the Court of Appeals held that summary judgment was warranted as to *both* the breach of contract and bad faith claims. Upon certiorari, the Georgia Supreme Court agreed, explaining the "made whole" doctrine does not require a commercial property insurer to prove the insured has been fully compensated before exercising its subrogation rights under the policy.

Woodcraft establishes that no "made whole" rule constrains a Georgia insurer's right to subrogate a commercial property claim. While the "made whole" doctrine acts as a limitation on an insurer's subrogation rights in non-property claims, the *Woodcraft* decision expressly noted that the Georgia legislature has declined to include a "made whole" provision in the property insurance statute O.C.G.A. § 33-7-6. Since the Georgia Supreme Court expressly declined to interpret Georgia law to require that a property claimant be made whole before subrogation can be pursued, the only way such a doctrine can apply to commercial property claims is if the Georgia legislature amends the statute. Perhaps equally important, *Woodcraft* provides commercial property insurers with grounds to dismiss bad faith and breach of contract claims asserted for resolving subrogation claims without the consent of the insured, even when the insured is a party to the subrogation.

It is important, however, for insurers to continue to include careful subrogation language in their commercial property policies in order to protect their subrogation interests. The Georgia Supreme Court specifically noted in *Woodcraft* that "[t]he 'made whole' doctrine does not apply to a commercial property insurance contract, such as the one here, *that expressly authorizes an insurer to pursue its subrogation rights after compensating the insured for damage to its property*." (Emphasis added.) Armed with well-drafted subrogation provisions and the *Woodcraft* decision, Georgia commercial property insurers can minimize speed bumps to enforcing their subrogation rights.

For more information on this case, contact Arthur York at 404.888.6131 or at arthur.york@swiftcurrie.com.

This Isn't Everything: How the Implied Trust Doctrine Impacts Insurable Interest

By: Sara M. Andrzejewski

Under Georgia law, a person or entity seeking to recover under a policy of insurance must maintain an insurable interest in the subject of the insurance in order to recover under the policy. O.C.G.A. § 33-24-4(b). Georgia law defines insurable interest as "any actual, lawful, and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction, or pecuniary damage or impairment." O.C.G.A. § 33-24-4(a). Under this statute, insurable interest is measured by the extent to which the insured is "damnified" by the loss to the property.

Title to the property is frequently used to measure an individual's insurable interest. However, legal title is not the only factor considered when determining the extent of an individual's insurable interest; instead, an equitable interest can suffice. *Republic Ins. Co. v. Martin*, 182 Ga. App. 390, 392 (1987).

Georgia courts have constructed an implied trust in order to serve some notion of equity on behalf of policyholders who no longer own the subject matter of the insurance policy. Such an implied trust could, on some occasions, permit the insured to recover under a policy of insurance. *Georgia Farm Bureau v. Smith*, 179 Ga. App. 399 (1986). Implied trusts are those trusts which are inferred by law from the nature of the transaction or the conduct of the parties. *See* O.C.G.A. § 53-12-133.

For example, in *Georgia Farm Bureau v. Smith*, the Georgia Court of Appeals held that Thomas Smith held the insured property in an "implied trust" for the benefit of his brother, James Smith. *Id.* James Smith originally acquired title to the insured property when he and Thomas Smith jointly purchased the property. Subsequent to the purchase, both James and Thomas spent $20,000.00 to build a house on the insured property. The brothers had a mutual agreement that James would live in the property during his lifetime and would be responsible for the taxes and insurance premium payments. James procured a policy of insurance identifying him as the sole named insured. However, after suffering some significant health problems, James deeded the property to Thomas so that, after his death, James' affairs would be settled. Nevertheless, James continued to live on the property after the transfer.

The Georgia Court of Appeals held that James maintained an insurable interest in the property and was entitled to recover under the policy. Since James provided some of the purchase price for the property, invested in improvements on the property, lived in the property both before and after he deeded the property to Thomas, and only deeded the property to Thomas upon contemplation of death, the Court held that the jury was authorized to find an implied trust existed.

In addition to the factors identified in *Smith*, if a person has an obligation to pay a debt secured by the insured property, such as a mortgage, that person may have an insurable interest in the property. *First of Ga. Ins. Co. v. Josey*, 129 Ga. App. 14, 16 (1973).

While Georgia courts have constructed implied trusts as a way to remedy financial injury to insureds as a result of a loss, the remedy is not absolute. Insureds cannot recover under an implied trust theory if they transferred the property with "unclean hands." The creation of an "implied trust" is a form of equitable relief and Georgia courts are unwilling to provide such a relief "at the insistence of a party who lacks clean hands with respect to those matters concerning which he seeks relief." *Griggs v. Griggs*, 242 Ga. 96, 97 (1978) (holding that no implied trust existed where the husband transferred property to his wife so that he could avoid income and estate taxes); *see also Whitley v. Whitley*, 220 Ga. 471, 474 (1964) (noting "there is a difference between the legitimate arrangement of one's affairs so as to minimize or avoid taxes and sham transactions designed to camouflage the actual situation").

In most claims, insurable interest questions do not arise. When insurable interest does become an issue, however, insurers should consider whether the implied trust doctrine would permit an insured to recover, even after transferring title or interest in the insured property.

For more information on this case, contact Sara Andrzejewski at 404.888.6155 or at sara.andrzejewski@swiftcurrie.com.

Events

Swift Currie Annual Property and Coverage Insurance Seminar
November 8, 2013 — Atlanta, GA
Cobb Energy Performing Arts Centre
9:15 am - 3:00 pm

Swift Currie Broker Seminar
December 5, 2013 — Atlanta, GA
Villa Christina
11:00 am - 1:45 pm

For more information on these programs or to RSVP, visit www.swiftcurrie.com/events.

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