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First Circuit Finds No Duty to Defend Construction Defect Claim, Exclusion Applies

Courts differ on whether faulty workmanship can stem from an "occurrence" under a commercial general liability policy. The First Circuit stayed out of that debate and found that an exclusion for damage to the insured's work applied.

Tocci was the construction manager for an apartment project. Delays and work quality issues surfaced. The project owner fired Tocci and then sued for breach of contract and a declaration that Tocci was lawfully terminated.

The complaint didn't allege negligence. But during discovery, it became clear that the claims involved defective work by Tocci's subcontractors that resulted in property damage to non-defective work on the project. For example, sheetrock was damaged from faulty roof work, inadequate sheathing allowed water to intrude into the building and form mold, and improper backfilling and soil compaction damaged concrete slab, wood framing, and underground pipes.

Tocci requested a defense and indemnity from its commercial general liability insurers. The primary insurer denied any duty to defend because the action didn't seek to hold Tocci liable for property damage caused by an "occurrence."

The coverage dispute was litigated, and the district court ruled for the insurer. The court found that the damage alleged in the complaint wasn't "property damage" because the damage was entirely at Tocci's own project. And even if there were "property damage," it wasn't caused by an "occurrence" because faulty workmanship isn't an accident but a business risk to be borne by the insured.

The ruling was appealed to the First Circuit. The court framed the key issue as whether under Massachusetts law, a general contractor's CGL policy covers damages to non-defective work resulting from defective work by subcontractors.

The First Circuit noted that there was a sharp split of authority on the issue. Even though the district court's reasoning was in line with rulings from other Massachusetts federal district courts, the First Circuit was hesitant to predict how the Massachusetts Supreme Judicial Court would rule. So, it sidestepped the issue by focusing on the policy's business risk exclusions, and in particular, exclusion (j)(6).

Under (j)(6), there is no coverage for "property damage" to "that particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." "Your work" was defined as "[w]ork or operations performed by you or on your behalf[.]"

Exclusion (j)(6) has an exception for "property damage" included in the "products-completed operations hazard." In short, (j)(6) does not apply if the work has been completed or abandoned.

Tocci argued that (j)(6) did not apply because it wasn't seeking coverage for the cost to replace the defective work itself (the faulty roof, inadequate sheathing, or backfill), but instead, the property damage caused by the subcontractor's defective work.

But the First Circuit found that Tocci's argument didn't jibe with Massachusetts law. The Massachusetts Supreme Judicial Court has found that similar exclusions apply to the entire unit of property on which the insured was retained to work. Tocci was retained for the entire project, not just a portion. As the general contractor, Tocci did not directly perform the construction. But it supervised and coordinated the work performed by subcontractors. The complaint alleged damage from Tocci's incorrectly performed work on the entire project. Thus, "[t]hat particular part of any property that must be restored, repaired or replaced because '[Tocci's] work' was incorrectly performed on it" refers to the entirety of the project where Tocci was the general contractor charged with supervising and managing the project as a whole.

The First Circuit said that its conclusion was bolstered by the Massachusetts SJC's overall approach to the scope and purpose of CGL policies. They cover tort liability for physical damage to another's

property, not contractual liability for the insured's economic loss. And at least one Massachusetts intermediate appellate court has concluded that this and similar exclusions apply to unintended damage to the project resulting from faulty workmanship.

The court next considered whether Tocci could satisfy the (j)(6) exception for the products-completed operations hazard. The court ruled the exception did not apply because Tocci was terminated from the project and never completed the work. And it noted that a contractor's work is not abandoned when it is fired from the project before finishing its work.

Thus, the insurers did not owe Tocci a defense or indemnity.

The case is *Admiral Ins. Co. v. Tocci Bldg. Corp.*, No. 22-1462 (1st Cir. Nov. 8, 2024).

Seventh Circuit Finds Insurer Had Duty to Defend Construction Defect Claim, Exclusions Waived

Applying last year's ruling by the Illinois Supreme Court, the Seventh Circuit found that an architectural firm was entitled to a defense in a suit alleging that the firm inadequately designed and oversaw the construction of a building.

A building owner sued the architectural firm for breach of contract and negligence over a litany of defects and design problems concerning a new Iowa building. The claim originated as a counterclaim in federal court but evolved into an action in Iowa state court. The coverage issue, however, was decided under Illinois law where the firm was based.

The architectural firm did not have professional liability coverage. Instead, it sought a defense under its commercial general liability policy. The policy contained common definitions of "occurrence" and "property damage."

"Occurrence" meant "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

"Property damage" meant either "physical injury to tangible property, including all resulting loss of use of that property" or "loss of use of tangible property that is not physically injured."

A coverage dispute played out in federal court and the district court ruled for the insurer. It held the insurer had no duty to defend because the construction defects suit did not assert "property damage" arising out of an "occurrence."

But the Seventh Circuit reversed, finding that the Illinois Supreme Court's decision in *M/I Homes*, handed down after the district court had ruled, warranted a different outcome.

The Seventh Circuit noted that the parties focused on whether the Iowa suit sought to hold the architectural firm responsible for repairing and replacing the work that it had contracted to provide. Indeed, many appellate courts in Illinois had held that for there to be "property damage," the damaged property must be something other than the contractor's own work. And many other Illinois courts had held that the need to repair or replace work was the "natural and ordinary consequence" of faulty workmanship rather than an unexpected "accident" capable of constituting an "occurrence." These courts recognized that a CGL policy is meant to protect against accidents, not run-of-the-mill breach of contract claims.

But as the Seventh Circuit explained, the Illinois Supreme Court has since rejected this approach. The Illinois high court found that "property damage" meant physical injury to tangible property, and if the property is altered in some way, that is enough. It doesn't matter that the damage occurs to property within the scope of the insured's project. Inadvertent faulty workmanship may be caused by an "occurrence."

The analysis does not end there, however. The Illinois Supreme Court in *M/I Homes* instructed that courts must also consider whether any exclusions apply. As we discuss above, most CGL policies have business risk exclusions that don't cover damage to the insured's own work. And in *M/I Homes*, the Illinois Supreme Court sent that issue back to the lower court for consideration.

But the insurer was not so fortunate here, as the Seventh Circuit ruled that the insurer waived two exclusions, having not raised them earlier. [It's unclear from the decision how this played out. Those exclusions wouldn't be reached if there were no "occurrence" in the first place, which the district court found. The insurer has since asked the Seventh Circuit to rehear that part of the decision.]

Applying *M/I Homes*, the Seventh Circuit found that the Iowa suit alleged "property damage" because it sought to hold the architectural firm responsible for damaging tangible property. The insurer's argument that the firm damaged its own project, the court emphasized, no longer carries weight.

The court also found that there was an "accident." The complaint alleged that the architectural firm negligently designed the building; it did not allege that the firm expected or intended the defects.

Thus, the court ruled that the insurer had a duty to defend.

The case is *Cornice & Rose Int'l, LLC v. Acuity Mut. Ins. Co.*, No. 23-1152 (7th Cir. Nov. 25, 2024).

Comment: The First Circuit in *Tocci* and the Seventh Circuit in *Cornice & Rose* reached different conclusions on similar facts. But the difference did not stem from whether faulty work is an "occurrence." The First Circuit passed on that issue – essentially assuming that it is – and went to the exclusions. The Seventh Circuit didn't consider the exclusions, finding that the insurer waived them. The insurer is asking the court to reconsider its waiver ruling. If the Seventh Circuit considers the exclusions, the outcome might be the same in both cases.

9th Circuit Finds Amber Heard's Insurer Did Not Breach Duty to Defend in Johnny Depp Defamation Case

In 2019, Johnny Depp sued his ex-wife, Amber Heard, for defamation in Virginia state court. Heard retained the Virginia law firm, Cameron McEvoy PLLC. Six months later, Heard noticed the suit to New York Marine and General Insurance Co. New York Marine agreed to defend Heard subject to a reservation of rights and continued the appointment of Cameron McEvoy. New York Marine reserved rights to deny coverage on the basis that Heard's conduct was "willful" and "intentional."

Heard claimed that New York Marine's reservation of rights created a conflict of interest and demanded that New York Marine appoint "independent counsel." New York Marine refused.

Heard then retained her own "independent counsel" and Cameron McEvoy later withdrew. Some of Heard's defense costs were paid by another insurer. New York Marine agreed to reimburse the insurer for a share paid to Heard's new counsel.

New York Marine next brought a declaratory judgment action for a ruling that it fulfilled its duty to defend Heard when it continued the appointment of Cameron McEvoy. Heard counterclaimed, alleging breach of New York Marine's duty to defend. The district court dismissed Heard's counterclaims and ruled for New York Marine.

The Ninth Circuit affirmed. The court held that no conflict of interest was created between New York Marine and Heard. Heard was represented by Virginia lawyers in the underlying suit. Unlike California, Virginia's ethics rules state that an attorney appointed by an insurer owes a duty only to the insured, not the carrier. In other words, potential disputes between an insurer and insured over indemnification do not put Virginia attorneys in a conflict position. For this reason, New York Marine did not have to provide Heard with independent counsel and thus did not breach its duty to defend.

The case is *New York Marine and Gen. Ins. Co. v. Heard*, No. 23-3399 (9th Cir. Nov. 25, 2024).

West Virginia Federal Court Finds Road Rage Shooting Did Not Implicate Automobile Liability Policy

A traffic dispute resulted in a road rage killing. A tractor trailer driver, James Armstrong, cut off another driver, Eric Sammons. In response, Sammons blocked Armstrong's tractor trailer and exited his vehicle to make threatening comments against Armstrong. Armstrong then shot Sammons, killing him.

Sammons' widow, Kim, sued Armstrong, Armstrong's freight transportation company, and the company's auto insurer, Canal Insurance Company. Canal filed a declaratory judgment action in federal court. The parties cross-moved for judgment on the pleadings.

The court granted Canal's motion and denied Kim Sammons' motion. The coverage issue under Florida law was whether Sammons' death arose from Armstrong's ownership, maintenance, or use of an automobile. The court concluded that the incident did not. Under Florida law, an injury arises from the

ownership, maintenance, or use of an automobile only if the injury arose out of the "inherent nature of the automobile." Moreover, the injury must arise out of the "natural territorial limits of an automobile" such that its actual use "must not have been terminated." In other words, the automobile must not only contribute to the cause of the injury-producing condition but must itself cause the injury.

The court found none of these factors was met. At the time of the shooting, both vehicles were parked. And the shooting was wholly unrelated to the inherent nature of the vehicle. At most, Armstrong's driving contributed to the hostilities between the parties that led to the deadly confrontation. But Sammons' death did not arise out of Armstrong's ownership, maintenance, or use of the vehicle.

The case is *Canal Ins. Co. v. Sammons*, 23-cv-737 (S.D.W.V. Nov. 19, 2024).

11th Circuit Finds Claim Was First Made Before D&O Policy's Coverage Period

THD Entities were single purpose entities created solely to buy stock in a holding company, Anchor. In late 2017, a group of investors purchased shares in THD Entities.

From January to March 2018, the investors corresponded with various Anchor board members. The investors complained that THD failed to make material disclosures before the stock purchase. THD allegedly failed to disclose that Anchor was conducting a $15M to $20M debt raise, which could jeopardize the investors' priority interest. The investors believed they overpaid for their THD shares based on Anchor's debt raise and demanded to rescind their purchases or have other THD's investors to buy out their shares.

On April 6, the investors served a formal demand letter, listing the Chairman of Anchor and pointing to THD's investments in Anchor.

In June 2018, the investors sued THD, but not Anchor, for rescission in Florida state court. In October 2018, the investors served Anchor with a non-party deposition subpoena. In November 2018, an Anchor board member was deposed, with others in attendance.

Anchor had a D&O policy with Certain Underwriters at Lloyds, London, effective November 30, 2018. By its terms, Lloyds has a duty to indemnify Anchor for any loss from a "Claim first made . . . during

the Policy Period . . . for any Directors and Officers Wrongful Act." "Claim" meant "a written demand for monetary, non-monetary or injunctive relief." And a "Wrongful Act" meant "any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act." The policy also provided that a "Claim shall be considered to have been first made against an Insured when written notice of such Claim is received by any Insured."

In 2021, Lloyds sued Anchor to rescind the policy because Anchor failed to disclose the disputes with THD investors. The district court awarded Lloyd's summary judgment on this ground. Anchor appealed.

The Eleventh Circuit affirmed, but for different reasons.

Anchor disputed that the events surrounding the investors' lawsuit amounted to a "claim" before the D&O policy took effect. The court thought otherwise.

Applying Florida law, the court held that the investors had made a written demand on Anchor by no later than April 6, 2018, when the demand letter was sent to the Anchor Chairman. The court rejected Anchor's argument that the investors only threatened future action, finding that there were several formal rescission demands amounting to a specific request to rectify legally cognizable damage.

Since the demands preceded the policy period, Lloyds was not obliged to provide coverage for the investors' claims.

The case is *Certain Underwriters at Lloyds v. Anchor Ins. Holdings, Inc*., No. 23-10364 (11th Cir. Nov. 20, 2024).