

EDITORS:

- Meryl R. Lieberman
mlieberman@traublieberman.com
- Copernicus T. Gaza
cgaza@traublieberman.com
- Brian Margolies
bmargolies@traublieberman.com

Individual Highlights:

Tex. Ct. Addresses Business Risk Excl.	1
D.N.J. Expands Eggleston Rule	1
5 th Circuit Revisits Inter-Insurer Subrogation	3
Disclosure in App. Not Notice of Claim	5

Texas Court Addresses Business Risk Exclusions

By Brian Margolies

Coverage litigation concerning the so-called “business risk” exclusions in a general liability policy often times requires a very detailed inquiry into the scope of the insured’s work. The recent decision by a Texas appellate court in *Evanston Ins. Co. v. D&L Masonry of Lubbock, Inc.*, 2011 Tex. App. LEXIS 2883 (Tex. App. Apr. 18, 2011) demonstrates the fact-intensive nature of such an inquiry.

The insured, D&L, was a contractor hired to perform masonry work on

the exterior of a public school. Scheduling delays on the project necessitated that D&L perform its work out of sequence; specifically, after the building’s new windows and window frames had been installed. In an attempt to protect these items from being damaged by mortar, D&L applied tape to the windows frames and applied soap and water to the windows. It was nevertheless determined that these preventative measures did not fully

Continued on Page 2

New Jersey Federal Court Expands Eggleston Rule to Inter-Insurer Disputes

By Copernicus T. Gaza

In the recently decided case captioned *Mazzoli v. Marina District Development Co., LLC*, 2011 U.S. Dist. LEXIS 39116 (D.N.J. Apr. 11, 2011), the United States District Court for the District of New Jersey had occasion to consider New Jersey’s so-called “Eggleston rule” in the context of an inter-insurer dispute. While the court ultimately held that there was no estoppel based on the facts presented, the decision makes clear that the *Eggleston* rule can apply as between co-insurers.

The “Eggleston rule” derives from the

1962 decision by the New Jersey Supreme Court in *Merchants Indem. Corp. v. Eggleston*, 37 N.J. 114, 179 A.2d 505 (N.J. 1962). The court held that when an insurer assumes control of the defense, without properly reserving its rights to later disclaim coverage, the insurer is estopped from doing so at a later time. Among other things, explained the court, a proper reservation of rights requires the insurer to offer the insured the opportunity to consent to selection of defense counsel.

Continued on Page 4

Texas Court Addresses Business Risk Exclusions (cont.)



protect the window frames from mortar, and that the measures actually caused further damage to the window frames. D&L was required to pay for the replacement of the frames at a cost of approximately \$58,000. It subsequently sought coverage under its general liability policy issued by Evanston Insurance Company.

Evanston denied coverage to D&L based on exclusions j(5) and j(6) of its policy, also referred to as the business risk exclusions. These exclusions barred coverage for “property damage” to

(5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the "property damage" arises out of those operations;

(6) That particular part of any property that must be restored, repaired, or replaced because "your work" was incorrectly performed on it.

Further, the policy defined D&L’s work as:

- a. Work or operations performed by you or on your behalf, and
- b. Materials, parts or equipment furnished in connection with such work or operations.

The court noted that the propriety of Evanston’s coverage determination hinged on whether D&L, in preparing the window frames for the application of the mortar, and in actually applying the mortar, constituted work on the window frames. Evanston argued, among other things, that by applying tape to the window frames, and that by applying soap and water to the windows, D&L was working on the window frames, and as such, the exclusions should apply. D&L argued, however, that its work was restricted to applying bricks and mortar around the window frames, and that in performing its work, it caused damage to someone else’s (i.e., the school’s property), which should trigger coverage under a general liability policy.

In considering this question, the court found persuasive the fact that D&L’s contract called for it to perform masonry work only rather than work on the school’s windows and window frames. While D&L literally performed work on the windows and window frames, such efforts, explained the court, “came about only as a prophylactic measure to attempt to prevent damage.” In other words, the court took a very literal approach in determining what property D&L “was performing work on.” While the scope of D&L’s work undoubtedly required it to come into contact with the window frames, the court distinguished such incidental contact from the work actually falling within the scope of D&L’s contract, which was masonry work.

Fifth Circuit Revisits Insurer's Right to Equitable Subrogation

by Brian Margolies

In 2007, the Texas Supreme Court issued its decision in *Mid-Continent Ins. Co. v. Liberty Mutual Ins. Co.*, 236 S.W.3d 765 (Tex. 2007), in which the court addressed co-insurers' rights of subrogation as against each other. The co-insurers both agreed that they owed a coverage obligation to their mutual insured. A dispute arose, however, as to the settlement value of the underlying matter. In order to effectuate the settlement, Liberty Mutual paid the entirety of the settlement and later commenced a contribution and subrogation action against its co-insurer, Mid-Continent. The Texas Supreme Court held that Liberty Mutual was not entitled to subrogation as against Mid-Continent, reasoning that since the mutual insured had been fully indemnified for the underlying loss, it no longer had a right of contractual recovery as against Mid-Continent to which Liberty Mutual could be subrogated. The court further held that when co-primary insurers both have "other insurance" clauses in their policies, "a co-insurer paying more than its proportionate share cannot recover the excess from the other co-insurers" through contribution.

Three years later, in *Amerisure Ins. Co. v. Navigators Ins. Co.*, 611 F.3d 299 (5th Cir. 2010), the Fifth Circuit had occasion to address the *Mid-Continent* rule in a situation in which one of the co-insurers denied a coverage obligation. The court held that the *Mid-Continent* rule did not apply where one of the co-

insurers denied a coverage obligation to the mutual insured. Under such circumstances, explained the court, it was irrelevant that the insured had been fully indemnified for the underlying loss. The court reasoned that a rule to the contrary "would have further deviated from settled principles of Texas insurance law by discouraging insurers from first defending and indemnifying and then seeking reimbursement for the costs that a coinsurer should have paid."

The Fifth Circuit recently revisited the *Mid-Continent* rule in its April 25, 2011 decision in *Maryland Cas. Co. v. Acceptance Indem. Ins. Co.*, 2011 U.S. App. LEXIS 8436 (5th Cir. 2011). As was the case in *Amerisure*, while Maryland and Acceptance were co-insurers, Acceptance denied a coverage obligation to their mutual insured. Maryland, defended and ultimately settled the underlying suit, and then brought its own suit against Acceptance for its pro-rated share of the settlement. Acceptance moved for summary judgment based on the decision in *Mid-Continent*, but was unsuccessful. The matter ultimately resulted in a jury verdict against Acceptance.

Acceptance appealed on two grounds, one of which was the *Mid-Continent* issue. Specifically, Acceptance argued that because the mutual insured was fully indemnified for the underlying loss, Maryland could not assert a subrogation claim. Citing to its prior decision in *Amerisure*, the Fifth Circuit reiterated its view that *Mid-Continent* should not be interpreted as an inflexible rule applicable whenever an insured is



5th Circuit Further
Narrows the Application
of *Mid-Continent*

Continued on Page 6

***Eggleston* Rule (cont.)**

In *Mazzoli*, Liberty International Underwriters (“LIU”), the insurer for a subcontractor on a construction project, agreed to provide a defense to the project owner and general contractor as additional insureds in connection with an underlying bodily injury suit. LIU, however, took the position that Selective, the insurer for another subcontractor on the project, also was required to provide a defense to these parties. While LIU and Selective were negotiating a cost-share arrangement, LIU’s named insured was voluntarily dismissed from the underlying suit. LIU thereafter took the position that the underlying injury could not have arisen out of its insured’s work, and as such, it no longer owed a defense to the owner and general contractor.

Selective filed a motion against LIU arguing that LIU was estopped from withdrawing its defense of these parties as LIU failed to have properly reserved its rights as required under *Eggleston*. LIU argued that the estoppel rule “is solely for the benefit of the insured,” and that Selective, therefore, did not have standing to raise estoppel. Relying on two decisions from New Jersey’s state court appellate division, the *Mazzoli*

court concluded that estoppel could apply as between co-insurers, reasoning that “in certain instances, an insurer will have exerted so much control over a case that allowing it to disclaim coverage would be prejudicial to both the insured and other insurers of the insured.”

The court, however, went on to conclude that unlike an insured asserting an estoppel argument, Selective was not entitled to a presumption of prejudice. Specifically, the court explained that “[t]here is no reason to presume that the control of a claim by a co-insurer is a ‘material encroachment upon the rights’ of an insurer, nor must we presume that there is a ‘resultant inequity’” since “[o]ften, the interests of co-insurers will be aligned.” Thus, explained the court, Selective had the burden of showing that it suffered actual prejudice as a result of LIU’s control of the defense.

Ultimately, the court held that Selective failed to satisfy this burden, and as such, LIU was not estopped from withdrawing from the defense. The *Mazzoli* decision makes clear, however, that estoppel will result when a co-insurer can satisfy this burden.

Disclosure of Claim to Underwriter Does Not Satisfy Policy's Notice of Claim Provision

By Brian Margolies

In the recently decided case titled *Atlantic Health Systems v. National Union Fire Ins. Co.*, 2011 U.S. Dist. LEXIS 39797 (D. N.J. Apr. 11, 2011), the United States District Court for the District of New Jersey had occasion to consider whether an insured's disclosure of a claim in connection with an application for a policy renewal is proper notice of claim. In doing so, the court made clear that coincidental transmission of information to an underwriter does not satisfy a policy's notice of claim provision.

Atlantic Health Systems ("AHS"), was insured under a claims made and reported directors and officers liability policy for the period May 1, 2003 to May 1, 2004. During the time the policy was in effect, a claim was made against AHS for an alleged antitrust violation. AHS, however, did not provide first notice of the claim to its insurer, National Union, until July 2004. AHS initially sought coverage under the renewal policy in effect for the subsequent period May 1, 2004 to May 1, 2005. National Union denied coverage under that policy on the basis that the claim was first made prior to the policy's inception. AHS then demanded that National Union consider the matter for coverage under the 03-04 policy. National Union denied coverage under that policy as well based on AHS' failure to have reported the claim prior to the policy's expiration. AHS subsequently argued that it had reported the underlying claim while the 03-04 policy was in effect because it was disclosed the claim in its renewal application for the 04-05 policy.

The notice provision in the 03-04 policy stated, in pertinent part, that:

Notice hereunder shall be given in

writing to the Insurer named in Item 8 of the Declarations at the address indicated in Item 8 of the Declarations. (Italics supplied.)

In the subsequent declaratory judgment action, AHS noted that the 03-04 policy only required that it provide a "writing" to National Union, and that policy did not specify the form or content of such writing. Thus, AHS argued, the renewal application satisfied the policy's "writing" requirement and served as proper notice.

Relying on *American Casualty Co. of Reading, Pennsylvania v. Continisio*, 819 F. Supp. 385 (D.N.J. 1993), *aff'd*, 17 F.3d 62 (3d Cir. 1994), the AHS court noted that "that courts will strictly enforce notice-of-claim requirements due to the purpose of sending notice under a claims-made insurance policy." That purpose, explained the court, is to invoke coverage under a policy, and as such, notice of claim must mean something more than "coincidental transmission of information." In other words, the mere fact that the insured disclosed the claim to the underwriter did not satisfy the requirement imposed on the insured of actually invoking coverage under the 03-04 policy. The court further explained that different recipients of claim information consider the information for different purposes. Whereas an underwriter requires claim information for the purpose of determining the scope of coverage for a renewal, a claims department requires such information in order to consider it for coverage. Finally, the court found it determinative that the insured sent the application to the underwriter at an address other than that specified in policy's declarations.



Continued on Page 6

**TRAUB LIEBERMAN
STRAUS &
SHREWSBERRY LLP**

7 SKYLINE DRIVE
HAWTHORNE, NY
(914) 347-2600

100 METROPLEX DRIVE
SUITE 203
EDISON, NJ
(732) 985-1000

303 WEST MADISON
SUITE 1200
CHICAGO, IL
(312) 332-3900

FIRST CENTRAL TOWER
360 CENTRAL AVE, 10th FL
ST. PETERSBURG, FL 33701
(727) 898-8100, FL

Website at:

www.traublieberman.com

Notice to Underwriter (cont.)

AHS argued, in the alternative, that even if its notice of claim was defective, National Union waived the notice requirement, because the underwriter, having received the renewal application, was aware of the claim and thus should have advised AHS to give proper notice to the claims department. The court rejected this argument on two grounds. First, the court concluded that there was nothing in the renewal application that should have alerted the underwriter to the fact that it

could be used for giving notice of a claim. Second, and more significantly, the court refused to place such a burden on the underwriter. Citing again the *Continsio*, the court noted "a growing line of cases prohibiting an insured from insisting that its insurer's underwriting department sift through a renewal application and decide what should be forwarded to the claims department on the insured's behalf."

Equitable Subrogation (cont.)

fully indemnified. As the court explained, "Acceptance absolutely refused to defend and indemnify [its mutual insured]; Maryland's insurance policy created a right of contractual indemnification; and its settlement of the [underlying] lawsuit preserved its right to seek reimbursement from Acceptance for those indemnification costs." The court further held that this contribution right extended to

defense costs incurred by Maryland.

Whether and to what extent the *Mid-Continental* rule is afforded a broad interpretation in Texas state courts remains to be seen. In Texas federal courts, however, it is clear that *Mid-Continent* has been limited to its facts and does not prevent a subrogation claim when a co-insurer wrongfully denies a coverage obligation.

About Traub Lieberman Straus & Shrewsberry LLP

Traub Lieberman Straus & Shrewsberry LLP has a national practice dedicated to insurance-related issues on all varieties of policies, including general liability, professional liability, pollution liability, directors and officers, employment practices and reinsurance.

This bulletin is intended for information purposes only and does not reflect the opinions of any author or this firm. This bulletin should not be relied on as legal advice.