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California Federal Court Finds a Breach of Contract Exclusion in a CGL Policy Bars All Coverage for a Construction Defect Action

BY:

The Southern District of California published a decision in May 2021 in *Associated Industries Ins. Co. v. Mt. Hawley Ins. Co.*, 2021 WL 1921016 (S.D. Cal. 5/12/21) concerning the scope of a breach of contract exclusion in a general liability insurance policy as applied to a construction defect action.

The suit was filed by Associated Industries Insurance Company against Mt. Hawley Insurance Company for equitable contribution for amounts spent to defend and indemnify the parties co-insured, referred to as JGCI in the decision. JGCI agreed to build a building for a third party pursuant to a written construction contract. The City of Davis issued a certificate of occupancy for the building on May 6, 2005. The City's permits stated the building was final on that date. Mt. Hawley issued the first of several annual general liability insurance policies in September 2005.

The building owner sued in May 2015 for damages for construction defects from the construction. Coverage for the claim was tendered to Mt. Hawley. It denied the tender based on an exclusion entitled Continuous or Progressive Injury and Damage Exclusion, which limits coverage for property damage caused or alleged to have been caused by any defect, deficiency, inadequacy or condition which first existed prior to the Mt. Hawley's policies' inception dates. The denial letter also stated it was not exhaustive of grounds for denial of the claim and did not waive any rights the insurance carrier might have to preclude or limit coverage. Subsequent to the denial of coverage, the building owner amended his complaint (almost certainly to avoid the 10-year statute of repose for construction defect claims) to allege that the building was not actually completed and ready for use until February 2006.

The parties filed cross-motions on the duty to defend. Ultimately, the federal district court agreed with Mt. Hawley that its breach of contract exclusion was dispositive as to the claimed duty to defend. That exclusion barred coverage for any claim or suit for property damage arising directly or indirectly out of breach of express or implied contract or warranty. Associated argued that the exclusion did not bar coverage for the non-contractual claims such as negligence. The court found support in both California and out-of-state authority for giving a broad interpretation to the breach of contract exclusion, and its "arising out of" language. It stated that the non-contractual claims incorporated the construction contract into their allegations and shared the operative factual allegations with the contractual claims, giving the necessary relationship to the written contract. Finally, the court held that the failure to include the breach of contract exclusion in the original denial letter was insufficient to satisfy Associated's burden to show by "clear and convincing evidence" that Mt. Hawley knowingly and intentionally relinquished its right to rely on the exclusion. The paragraph reserving rights to rely on unspecified policy provisions to deny coverage was pointed to as evidence as to the lack of waiver.