

Courts Continue to Split on Whether Defense Obligation Is a First Party Benefit Under Colorado Law, but Agree Duty to Defend Is a Joint and Several Obligation

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In *D.R. Horton, Inc.—Denver v. Mountain States Mutual Casualty Co.*, No. 12-cv-01080 (February 25, 2013), another U.S. District Court judge for the District of Colorado determined a liability insured seeking defense costs from its insurer may qualify as a “first-party claimant” for purposes of Colorado’s Unfair Claim Settlement Practices Act, potentially entitling the insured to recover unpaid defense costs, attorneys’ fees in prosecuting the recovery action and two times the unpaid defense costs as a penalty.

D.R. Horton, Inc. — Denver and D.R. Horton, Inc. (collectively Horton) developed a residential community in Arapahoe County, Colo., known as Windemere. Following construction, the homeowners’ association sued Horton based upon alleged construction defects resulting from work performed by subcontractors. Each of Horton’s subcontractors was insured under a liability insurance policy provided by one or more of the defendant-insurers and each policy named Horton as an additional insured. Although the defendant-insurers had allegedly accepted Horton’s tender of the underlying suit, they had either refused to pay or only paid a small portion of defense costs billed to them. Consequently, Horton filed suit, asserting three claims: (1) declaratory judgment of the respective rights and obligations of the parties; (2) breach of contract on the basis that each insurer had a joint and several contractual obligation to defend; and (3) bad faith liability under C.R.S. § 10-3-1116, Colorado’s Unfair Claim Settlement Practices Act.

The Court initially addressed whether an insured or additional named insured qualified as a first-party claimant vis-à-vis its liability insurer for purposes of C.R.S. §§ 10-3-1115 and 10-3-1116 with respect to unpaid defense costs. C.R.S. 10-3-1116 provides, in relevant part:

A first-party claimant as defined in section 10-3-1115 whose claim for payment of benefits has been unreasonably delayed or denied may bring an action in a district court to recover reasonable attorney fees and court costs and two times the covered benefit.

C.R.S. § 10-3-1115 defines a first-party claimant as:

“First-party claimant” means an individual, corporation, association, partnership, or other legal entity asserting an entitlement to benefits owed directly or on behalf of an insured under an insurance policy.

On its face, the statute does not address whether an insured under a “third-party” liability policy qualifies as a first-party claimant under the Unfair Claim Settlement Practices Act where the insured is seeking defense costs from its insurer. Courts addressing the statute have split on the issue. Two U.S. District Court judges in Colorado interpreted the statute using a traditional first-party vs. third-party dichotomy and held that the statute does not apply to either the defense or indemnity

obligations in a liability policy. See, *New Salida Ditch Co., Inc. v. United Fire & Cas. Co.*, 2009 WL 5126498, at *5 (D. Colo. Dec. 18, 2009) (Judge Kane) and *Gustafson v. American Family Mut. Ins. Co.*, 2012 WL 4755357, at *11 (D. Colo., Oct. 5, 2012) (Judge Brimmer). On the other hand, two other U.S. District Court judges in Colorado, and at least one state trial court judge, reasoned that the defense obligation is “owed directly to or on behalf of [the] insured,” and, therefore, under the plain language of the statute, a first-party claim. See, *D.R. Horton, Inc. – Denver v. Travelers Indem. Co.*, 2012 WL 5363370 (D. Colo. Oct. 31, 2012) (Judge Martinez); *Sterling Constr. Mgmt., LLC v. Steadfast Ins. Co.*, 2011 WL 3903074, at *12 (D. Colo. Sept. 6, 2011) (Judge Krieger); *Stresscon Corp. v. Rocky Mountain Structures, Inc.*, No. 09CV3252, slip op. at 1-5 (April 22, 2010) (Judge Hoffman) (currently pending in the Colorado Court of Appeals).

In the subject case, Judge Jackson adopted the Martinez-Kreiger-Hoffman view and held that C.R.S. § 10-3-1116 applied to insureds seeking to recover defense costs under a liability policy, even an insured that is an additional insured, such as Horton, and not a named insured. See also, *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 20 (Tex. 2007) (holding that defense costs of a named insured are first-party claims subject to Texas’ prompt-pay statute, §§ 542.051-061, Texas Ins. Code).

Until the issue is settled in Colorado, insurers with Colorado insureds should be cognizant that the defense obligation may be viewed as a first-party benefit, entitling the insured to recover two times the unpaid (or late-paid) defense costs plus the costs of prosecuting the recovery action if those benefits are determined to have been “unreasonably delayed or denied.”

Judge Jackson next considered an issue not yet addressed by Colorado’s state appellate courts: whether there is a joint and several duty to defend where multiple insurers have such a duty. Judge Jackson, joining his colleague Judge Martinez, responded in the affirmative, holding that where a number of policies equally contemplate the duty to defend, the obligations of the insurers to defend are joint and several. There are no dissenting views on this issue on the Colorado Federal Court Bench. The court left the issue of allocation of defense costs to be worked out among insurers, or the courts, if necessary.

Following *D.R. Horton, Inc. – Denver*, defense counsel may expect to see a rise in the number of liability insureds pursuing Colorado Unfair Claim Settlement Act claims against their insurers. Significantly, left open is the question of whether a liability insured’s § 10-3-1116 claims against its insurer may be assigned to a third-party claimant. The court’s interpretation of a first-party claimant under §§ 10-3-1115 and 10-3-1116 potentially creates new and very valuable extracontractual claims that insureds might attempt to assign as part of their settlements with third-party claimants.

The attorneys of Cozen O’Connor will continue to keep our valued clients apprised of developments in this area.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:

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