ALERT
OCTOBER 2, 2008

GLOBAL INSURANCE GROUP
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Recent Insurance Coverage Issues

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U.S. DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON HOLDS THAT MONTROSE ENDORSEMENT BARS COVERAGE FOR PROPERTY DAMAGE KNOWN TO INSURED PRIOR TO POLICY PERIOD

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In *Trinity Universal Ins. Co. v. Northland Ins. Co.,* No. C07-0884-JCC (W.D. Wash. Sept. 23, 2008), District Judge John Coughenour granted an insurer's motion to dismiss claims for breach of contract and contribution based on the insured's knowledge of the relevant damage prior to the inception of the policy period. Although the Court cited and relied upon a 2002 Washington Supreme Court case interpreting different policy language, *Trinity Universal* is notable as perhaps the first court decision applying the "Montrose Endorsement" as insurers intended.

The "Montrose Endorsement" was adopted by Insurance Services Offices, Inc. in 1999 to respond to the California Supreme Court's decision in *Montrose Chemical Corp. v. Admiral Ins. Corp.,* 913 P.2d 878 (Cal. 1995), which held that the insured's knowledge of "property damage" prior to the policy period did not preclude coverage under a CGL policy so long as the insured had not yet been determined to be liable. "[T]he loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss." *Montrose,* 913 P.2d at 906.

The "Montrose Endorsement" amends the CGL insuring agreement to provide that there is no coverage for "bodily injury" or "property damage" if, prior to the policy period, the insured knew of the "bodily injury" or "property damage." Some courts have interpreted this endorsement narrowly, requiring a showing that the insured knew of the specific injury or damage at issue in order for coverage to be barred. *See, e.g., Essex Ins. Co. v. H&H Land Development Corp.,* 2007 U.S. Dist. LEXIS 89904 (M.D. Ga. 2007) (although insured knew of damage caused by an increase in surface water runoff on some properties neighboring its development, there was insufficient evidence that the insured knew that the claimants' properties, in particular, had been so damaged); *Transportation Ins. Co. v. The Regency Roofing Companies, Inc.,* 2007 U.S. Dist. LEXIS 74364 (S.D. Fla.) (insured's pre-policy knowledge of water intrusion was not sufficient to preclude coverage for mold damage).

The *Trinity Universal* Court, on the other hand, applied the endorsement somewhat more broadly. The primary issue presented in *Trinity Universal* was whether there was coverage for an underlying claim between general contractor (Pryde) and a stucco subcontractor (Jefferson) for allegedly defective work on a condominium project. Pryde received complaints about water leaks around the windows in the completed project in 1999. Initial tests by a third-party were inconclusive as to the cause of the leaks. When continued water intrusion was reported in 2000, Jefferson conducted tests and concluded that the leaks were more likely caused by the windows, not the stucco it had installed. Nevertheless, when the condominium homeowners association sued Pryde for construction defects in April 2001, Pryde in turn asserted a third-party claim against Jefferson for the leaks.

Jefferson tendered the claim to Trinity Universal Insurance Company of Kansas and Mid-Century Insurance Company, its insurers from 1998 to May 2001. Jefferson did not tender the claim to Northfield Insurance Company, from which it had purchased a policy on May 11, 2001.

Trinity Universal and Mid-Century provided a defense and indemnified Jefferson for a settlement of the underlying construction defect lawsuit. Trinity Universal and Mid-Century then filed suit against Northfield, seeking contribution and alleging breach of contract, bad faith, and violation of

Washington's insurance regulations. Northfield filed a motion to dismiss on summary judgment, arguing its policy did not apply because Jefferson knew of the damage giving rise to the claim prior to the policy's inception. The Plaintiff insurers agreed that Northfield was permitted to deny coverage "where the insured has knowledge of a loss prior to the inception of coverage," but argued that Jefferson was not on "actual subjective notice of the 'leak' issue," because Jefferson personnel never believed their work contributed to the water intrusion at the condominiums. Based on this, the Plaintiff insurers argued the claim did not constitute a known loss.

The Court granted the motion to dismiss the breach of contract and contribution claims based on the following endorsement contained in the Northfield policy:

> AMENDMENT OF INSURING AGREEMENT – KNOWN INJURY OR DAMAGE
>
> b. This insurance applies to "bodily injury" and "property damage" only if:
>
> …
>
> (3) Prior to the policy period, no insured listed under Paragraph 1. of Section 11 – Who Is An Insured and no "employee" authorized by you to give or receive notice of an "occurrence" or claim, knew that the "bodily injury" or "property damage" had occurred, in whole or in part. If such a listed insured or authorized "employee" knew, prior to the policy period, that the "bodily injury" or "property damage" occurred, then any continuation, change or resumption of such "bodily injury" or "property damage" during or after the policy period will be deemed to have been known prior to the policy period.

Trinity Universal Order at 7. The policy also defined "property damage" as "[p]hysical injury to tangible property, including all resulting loss of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it." *Id.* "Thus," the Court observed, "the insurance policy explicitly excludes from coverage any physical injury to tangible property known by the insured to have occurred 'in whole or in part' prior to the policy period." *Id.*

In rejecting the Plaintiff insurers' argument that the endorsement did not apply to bar coverage because Jefferson did not have notice that it was liable for the water damage, the Court relied on *Overton v. Consolidated Ins. Co.,* 38 P.3d 322, 325 (Wash. 2002). In *Overton,* the Court dismissed similar claims for breach of contract and contribution for a contamination loss, observing, "the proper inquiry is whether [the insured] expected the physical injury to tangible property." *Overton,* 38 P.3d at 329. "[R]egardless of when [the insured] became *liable* … for contribution to the cleanup costs, the *property damage* was not unexpected from [the insured's] standpoint." *Id.* at 328. Although the decision in *Overton* was based on the definition of "occurrence" and the "known-loss principle," the *Trinity Universal* Court analogized *Overton* and summarized, "The relevant inquiry is simply whether the insured knew of the underlying property damage prior to the policy period regardless of when it became liable for such damage." *Trinity Universal* Order at 8.

Although Jefferson had concluded that its work did not cause the water damage, it had notice of the water intrusion problems on the project before the Northfield policy was issued on May 11, 2001. The Court concluded, "Under the explicit terms of the insuring agreement, an insured's knowledge of property damage prior the policy period constitutes a known-loss excluded from coverage. Because it is undisputed that Jefferson had notice of the water intrusion and damage at the … project prior to the policy period, [Northfield] properly denied coverage." *Trinity Universal* Order at 9.

The court also granted Northfield's motion to dismiss the Plaintiff insurers' claims for bad faith and violation of the insurance regulations. First, the Court noted that the Plaintiffs failed to present any evidence that they had obtained an assignment from Jefferson to its bad faith claim. Under Washington law, an action for breach of good faith against an insurer may be brought only by an insured; a third party claimant has no right of action against an insurance company for bad faith. *Trinity Universal* Order at 9 (citing *Tank v. State Farm Fire & Cas. Co.,* 715 P.2d 1133, 1140 (Wash. 1986)). An insured may assign its rights to a bad faith claim to a third party. *Id.* (citing *Safeco Ins. Co. of Am. v. Butler,* 823 P.2d 499, 508 (Wash. 1992)). But without evidence of an assignment, the Plaintiffs lacked standing to bring the bad faith claim.

The Court also concluded that the Plaintiffs failed to establish that Northfield's conduct in denying coverage constituted bad faith. To establish a bad faith claim, a plaintiff must show that the insurer's conduct was "unreasonable, frivolous, or unfounded." *Trinity Universal* Order at 10 (citing *Kirk v. Mt. Airy Ins. Co.,* 951 P.2d 1124, 1126 (Wash. 1998)). The Court concluded that Northfield's denial of coverage was based on a reasonable interpretation of the insuring agreement, which

specifically excluded coverage for known property damage, and there was no evidence Northfield's conduct was unreasonable, unfounded or frivolous.

Finally, the Court dismissed the claim for unfair claims settlement practices in violation of the Washington insurance regulations. The Court relied on *Tank v. State Farm Fire & Cas. Co.*, 715 P.2d 1133, 1140 (Wash. 1986), wherein the court held that the insurance regulations do not create a cause of action against insurers for third party claimants. *Id*. Instead, enforcement of the regulations on behalf of third parties is the province of the insurance commissioner.

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 Tom Jones (tjones@cozen.com, 206.224.1242) or Megan Kirk (mkirk@cozen.com, 206.373.7242).