PLUNKETT COONEY

Burden of Proof on Exception to Exclusion, JIF, Regular Use Exclusion, Attorney-Client Privilege & Bad Faith Coverage Update

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Burden of Proof on Exception to Exclusion – Nevada

Zurich American Ins. Co. v. Ironshore Specialty Ins. Co.
--- P.3d ---, 2021 WL 5022615 (Nev. Oct. 28, 2021)

The Nevada Supreme Court answered two questions certified to it by the U.S. Court of Appeals for the Ninth Circuit relating to the relative burden of proof between insurer and insured regarding exceptions to exclusions to coverage.

Zurich American Insurance Company and American Guarantee and Liability Insurance Company (collectively Zurich) issued a series of insurance policies to various subcontractors involved in the development and building of thousands of residences in Nevada. After construction was completed, the subcontractors began obtaining insurance from Ironshore Specialty Insurance Company (Ironshore). The policy issued by Ironshore contained a "Continuous or Progressive Injury or Damage" exclusion from coverage for "property damage ... which first existed, or is alleged to have first existed, prior to the inception of this policy," except for property damage which "is sudden and accidental and takes place within the policy period."

Subsequently, homeowners who had bought some of the residences built by the subcontractors and the developers who hired them, brought a total of 14 construction defect lawsuits against the developers, who then brought the insured subcontractors into the suit as defendants. Zurich defended the subcontractors under its earlier-issued policies and later sued Ironshore seeking contribution and indemnification for defense and settlement costs, as well as a declaration that Ironshore owed a duty to defend the subcontractors (*Nevada Zurich I*).

The district court ruled in favor of Ironshore, noting Zurich had failed to show that the sudden and accidental exception to the exclusion applied. However, in another suit between Zurich and Ironshore (*Nevada Zurich II*), the district court concluded that it was Ironshore's burden to establish the exception to the exclusion applied, and it failed to carry that burden. The appellate court certified the questions in these cases to the Nevada Supreme Court because, as the Supreme Court noted, "this

court has yet to speak directly to the issue of whether the insurer or the insured has the burden of proving that the exception to an exclusion of coverage applies when determining the duty to defend."

After examining the law in other jurisdictions, the Supreme Court concluded that "the majority rule, which places the burden on the insured to, in essence, re-establish coverage where it would not otherwise exist, accords with these [general contracting] principles [followed in Nevada jurisprudence]." The Supreme Court held that it was the insured's burden to prove that an exception to the exclusion applies. In so holding, the high court noted that with respect to the duty to defend, this burden is "lighter" than proving a duty to indemnify because "only the *potential* for coverage must be proven."

The Supreme Court also resolved the open question of what, if any, extrinsic evidence the insured may rely upon to prove that the insurer has a duty to defend. The high court concluded that "[s]ince the duty to defend must be determined at the outset of litigation based upon the complaint and any other facts available to the insurer, we hold that the insured may use extrinsic facts that were available to the insurer at the time it tendered its defense to prove there was a potential for coverage under the policy and, therefore, a duty to defend."

By: Stephanie Brochert

Joint Insurance Funds – Superior Court of New Jersey, Appellate Division

Statewide Ins. Fund v. Star Ins. Co.
No. A-4148-19, 2021 WL 4898504 (N.J. Super. Ct. App. Div. Oct. 21, 2021)

The Superior Court of New Jersey, Appellate Division, held that a statutorily created Joint Insurance Fund (JIF) was not considered a commercial insurer for purposes of funding a settlement between the city of Long Branch (Long Branch) and the family of a deceased 12-year-old boy. The boy had dug a hole in the sand at Long Branch beach, but the sand collapsed on top of him, and he suffocated before employees of the Long Branch Beach Patrol could rescue him. The family sued Long Branch and its employees for negligence.

At the time of the incident, Long Branch was a member of Statewide Insurance Fund (Statewide), a JIF formed pursuant to New Jersey statute. Statewide provided Long Branch $10 million in general liability coverage per occurrence. Long Branch also purchased a policy from Star Insurance Company (Star) with $10 million in coverage per occurrence. On April 28, 2017, Statewide filed a complaint and sought a declaratory judgment against Star for excess insurance coverage. In the interim, Statewide and Star agreed to fund a settlement between Long Branch and the family. In March 2018, Statewide filed an

amended complaint, alleging its coverage was not considered "insurance" pursuant to the New Jersey statute for the purposes of applicable "other insurance clauses." Therefore, Statewide argued it was not obligated to fund the settlement. The trial court granted Statewide's motion for summary judgment, finding that Star was solely responsible for payment of the settlement.

The appellate court affirmed the lower court's decision, reasoning that Statewide – as a JIF – was statutorily protected from being considered insurance by third parties per the New Jersey Legislature. The relevant statute provided: "A joint insurance fund established pursuant to the provisions of this act is not an insurance company or an insurer under the laws of this State, and the authorized activities of the fund do not constitute the transaction of insurance nor doing an insurance business." Because Statewide was a JIF, and not an insurer providing insurance, Star's "other insurance" clause was not applicable to Statewide and, thus, Star's policy was not excess over Statewide's policy.

By: Joshua LaBar

Regular Use Exclusion - Superior Court of Pennsylvania

Rush v. Erie Ins. Exch.
--- A.3d ---, 2021 WL 4929434 (Pa. Super. Ct. Oct. 22, 2021)

The Superior Court of Pennsylvania upheld a trial court's ruling that the "regular use" exclusion, which limits the scope of underinsured motorist (UIM) coverage, was unenforceable as it violated Pennsylvania's Motor Vehicle Financial Responsibility Law (MVRL). The regular use exclusion precluded UIM coverage for "[b]odily injury to 'you' or a 'resident' using a non-owned 'motor vehicle' or a 'non-owned' miscellaneous vehicle which is regularly used by 'you' or a 'resident', but not insured for uninsured or underinsured motorist coverage under this policy."

Pursuant to the MVRL, an automobile insurer is required to provide UIM coverage when the insured satisfies three requirements: (1) they suffered injuries arising out of the maintenance or use of a motor vehicle; (2) they are legally entitled to recover damages from the at-fault underinsured driver; and (3) they did not reject UIM coverage by signing a valid rejection form.

The appellate court emphasized that, under the MVRL, the scope of UIM coverage is broad – "[i]t requires UIM coverage whenever an insured suffers injuries 'arising out of the … use of a motor vehicle. '"

Next, the appellate court reasoned that the "regular use" exclusion was in conflict with the "broad language" of the MVRL, as the exclusion limited coverage to the insured's use of an owned or

occasionally used vehicle. Because of this conflict, the appellate court held the "regular use" exclusion was unenforceable.

Attorney-Client Privilege and Bad Faith – Fourth Circuit (South Carolina Law)

ContraVest Inc. v. Mt. Hawley Ins. Co.
No. 20-1915, 2021 WL 4782687 (4th Cir. Oct. 13, 2021)

The U.S. Court of Appeals for the Fourth Circuit held than an excess insurer did not act in bad faith when it refused coverage for a $9 million judgment against a contractor accused of building defects. The appellate court further held that an insurer's denial of liability did not waive the attorney-client privilege.

In September 2011, Plantation Point Horizontal Property Regime Owners Association Inc. (Plantation Point) filed a construction defect suit in South Carolina state court against ContraVest Inc. and ContraVest Construction Company (ContraVest), claiming ContraVest was responsible for a defect at a multiunit condominium complex (underlying action). ContraVest sought coverage from Mt. Hawley Insurance Co. (Mt Hawley), which issued two excess insurance policies to ContraVest. Throughout a protracted exchange of communications, Mt. Hawley asserted that it was not obligated under any of its excess insurance policies to defend or indemnify ContraVest in the underlying action. In 2014, the parties to the underlying action agreed to mediate the dispute, and ContraVest ultimately agreed to a $9 million confession of judgment against it. ContraVest assigned to Plantation Point its rights to recover under the Mt. Hawley policy. Plantation Point and ContraVest brought a bad faith action against Mt. Hawley in South Carolina state court and Mt. Hawley removed the case to federal court.

During discovery, the plaintiffs filed a motion to compel production of privileged communications between Mt. Hawley and its coverage counsel. The magistrate judge recommended that Mt. Hawley be deemed to have waived the attorney-client privilege based on the so-called "at issue" exception. The district court agreed with the magistrate judge's recommendation, granted the plaintiffs' motion to compel and ordered the insurer to produce the communications for *in camera* review. Mt. Hawley appealed.

In 2018, the appellate court "certified the following question to the Supreme Court of South Carolina: 'Does South Carolina law support application of the 'at issue' exception to the attorney-client privilege such that a party may waive the privilege by denying liability in its answer?'" The Supreme Court answered that "in a tort action against an insurer for bad faith refusal to defend or indemnify its insured,

'a denial of bad faith and/or the assertion of good faith in the answer does not, standing alone, place a privileged communication 'at issue' in a case such that the attorney-client privilege is waived.'" On remand, the district court denied the motion to compel. The district court also granted summary judgment in favor of Mt. Hawley on the bad faith claim. The plaintiffs appealed both rulings.

As to the discovery dispute, the appellate court upheld the district court's ruling, finding that the court did not abuse its discretion in denying the discovery being sought. The appellate court reasoned that district courts are given "wide latitude in controlling discovery" and the appellate court will not disturb discovery orders "absent a showing of clear abuse of discretion."

As to the summary judgment ruling, the appellate court held that the district court's ruling was proper. The appellate court indicated that the key issue was whether ContraVest suffered consequential damages that would authorize a bad faith claim against Mt. Hawley. Plaintiffs' theory of consequential damages was based solely on the confession of judgment. The appellate court held that the consequential damages alleged by ContraVest relative to the confession of judgment "constitute *damnum absque injuria*, that is 'loss or damage without injury.'" The appellate court reasoned that the plaintiffs failed to articulate how the confession of judgment could factually or legally constitute consequential damages sustained by ContraVest. Therefore, the appellate court upheld the judgment entered by the district court, dismissing the claim for bad faith.

By: Michael Hanchett

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