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Delaware Supreme Court Holds That an Appraisal Action Is Not a Securities Claim within the Meaning of a D&O Policy

Reversing the Superior Court, the Delaware Supreme Court held that an appraisal action brought by dissenting shareholders was not a Securities Claim as defined by a directors and officers (D&O) policy because the policy required a violation of law. An appraisal action is instead a neutral proceeding to determine fair stock value, not a proceeding that addresses wrongdoing or breach of fiduciary duties. The insurer was not required to pay the insured's legal costs in the appraisal action or prejudgment interest the insured owed to shareholders.

The Case

Solera Holdings, Inc., a software company, was a publicly traded company until it was acquired by an affiliate of Vista Equity in March 2016. Shortly after Solera announced the transaction in September 2015, a group of investors sued Solera and its directors and officers for breach of fiduciary duties. That case was ultimately dismissed.

A majority of Solera's stockholders approved the merger and the transaction closed for an agreed price of $55.85 per share. A group of shareholders who objected to the merger filed an appraisal action under 8 Del. C. § 262, seeking a determination of the fair value of their shares. They sought $84.65 per share. The Chancery Court concluded that the fair value of Solera's common stock was $53.95 per share, an amount less than the merger price. The court ordered Solera to pay the dissenting stockholders at $53.95 per share plus prejudgment interest in the

amount of $38,387,821.61. Solera incurred over $13 million in defending against the appraisal action.

Solera sought coverage for the interest payment and its defense costs under its primary and excess D&O policies. The policies applied to "Loss resulting solely from any Securities Claim first made against an Insured during the Policy Period for a Wrongful Act." The term "Loss" included both prejudgment interest and defense expenses. But the issue turned on the meaning of "Securities Claim," defined as a claim:

> made against [Solera] for any actual or alleged violation of any federal, state or local statute, regulation, or rule or common law regulating securities, including but not limited to the purchase or sale of, or offer to purchase or sell, securities ….

Solera argued that the appraisal action was a Securities Claim because it alleged a violation of Delaware's appraisal statute, which is a law regulating securities. The insurers denied coverage and Solera filed an action for breach of contract and declaratory judgment. The primary insurer settled, but the excess insurers filed summary judgment motions.

The excess insurers argued that an appraisal action did not meet the definition of a Securities Claim because there was no violation of any law or regulation. They argued that a violation must involve wrongdoing and that wrongdoing is not a required element of an appraisal action under Delaware law. The insurers contended that a determination of fair value is a neutral proceeding and does not involve an inquiry into claims of wrongdoing in the merger.

The lower court denied the excess insurers' motion and they appealed.

The Delaware Supreme Court's Decision

The Delaware Supreme Court reversed. It held that an appraisal action is not a Securities Claim because it does not involve a violation of law. The court reached its decision based on the

plain meaning of the word “violation” and legal precedent that holds an appraisal is not a determination of wrongdoing.

First, looking to ordinary dictionaries, the court determined that the plain meaning of the term “violation” suggests an element of wrongdoing.

Next, looking to the historical background of the appraisal remedy, the court concluded that it is limited to the determination of the fair value of the dissenters’ shares as of the date of the merger or consolidation. An appraisal action is not designed to address wrongdoing. Rather, any such wrongdoing, as was the case here, is typically addressed in a separate stockholder fiduciary litigation brought by stockholders against the target board’s directors. The purpose of an appraisal action is neutral and is not designed to address breaches of fiduciary duty or other wrongdoing. Indeed, the court noted that the appraisal petition here was a ten-paragraph petition that contained no allegations of wrongdoing. Also, Solera did not contend that Section 262 itself was violated.

Finally, the court reinforced its decision by pointing to an “unbroken line” of cases that hold that an appraisal under section 262 "does not involve any inquiry into claims of wrongdoing.”

The case is *In re Solera Ins. Coverage Appeals*, Nos. 413-2019 and 418-2019 (Del. Oct. 23, 2020).

Massachusetts Supreme Judicial Court Holds That Workers’ Compensation Insurers Are Not Required to Pay for Medical Marijuana Costs

Mindful of the uncertain legal landscape of medical marijuana law, and the difficult regulatory environment, the Massachusetts high court held that workers’ compensation insurers are not required to reimburse injured employees who use medical marijuana to treat chronic pain.

The court reasoned that Massachusetts's statute legalizing marijuana for medical use expressly provides that health insurers are not required to reimburse any person for the expense of the medical use of marijuana, and that the workers' compensation law requiring reimbursement of reasonable medical expenses did not override this language.

The Case

Claimant injured his knee during the course of his employment and underwent multiple surgeries. Complications developed and he was ultimately diagnosed with regional pain syndrome. The claimant was prescribed medical marijuana to ease his chronic pain, which allowed him to eliminate the use of opioids. The claimant sought workers' compensation benefits for medical expenses incurred from his medical marijuana treatment. His claim was denied.

The administrative judge hearing his appeal found that the claimant received positive benefits from his medical marijuana treatment, but that the insurer could not be ordered to pay in light of marijuana's illegal status at the federal level and based on the language of the state's medical marijuana act. Requiring the insurer to pay would put it at risk of federal prosecution.

The matter made its way up to the Massachusetts Supreme Judicial Court.

The Decision

By way of background, marijuana is classified under federal law as a Schedule I substance, and thus, cannot be prescribed for medical use.

In 2012, Massachusetts voters approved a ballot initiative to legalize marijuana use for medicinal purposes. The stated purpose of the act was to protect patients, caregivers, and medical professionals from prosecution or punishment under Massachusetts law for engaging in the voluntary medical use of marijuana. The act further stated that "[n]othing in this law requires

any health insurance provider, or any government agency or authority, to reimburse any person for the expenses of the medical use of marijuana."

The court found that drafters of Massachusetts's medical marijuana act were aware of the federal pitfalls and sought to steer clear of them by carving a narrow path through the "regulatory thicket." The act recognizes that marijuana possession and distribution remain illegal under federal law and that Massachusetts has no authority to alter the illegal status of marijuana at the federal level. The court noted that providing authorization for medical marijuana use in this environment remains somewhat of a "high wire act." The statute seeks to minimize the possibility of federal prosecution or federal preemption by carefully setting forth the scope of its protections.

Within this context, the statute expressly states that nothing in the law requires health insurers to reimburse any person for medical marijuana expenses. The court then noted that requiring companies that insure the health of medical marijuana patients to pay for their marijuana usage raises the stakes much higher. Unlike the patients and doctors covered by the act, insurance companies would not be participating in the patient's use of a federally proscribed substance voluntarily. "It is one thing to voluntarily assume a risk of Federal prosecution; it is another to involuntarily have such a risk imposed upon you," the court emphasized. Thus, it is not unreasonable, the court noted, "given the current hazy regulatory environment and shifting winds of federal enforcement, for insurance companies to fear that paying for a claimant's marijuana could expose them to potential criminal prosecution." Further, the court recognized that insurance companies are typically involved in interstate commerce, thereby raising federal regulators' concerns.

The court noted that "[b]y excluding third-party insurers from being obligated to reimburse medical marijuana patients under the statute and limiting the protections of the act to those willing to assume the risk of exposure to Federal prosecution, these statutory provisions lessen the likelihood of Federal intervention and preemption."

The court further rejected claimant's argument that the workers' compensation statute requiring reimbursement for reasonable and necessary medical expenses requires third-party reimbursement because medical marijuana has been legalized in Massachusetts. The court said "[s]uch an interpretation ignores the fact that marijuana was previously illegal under Massachusetts law, that it remains illegal under Federal law, and that the medical marijuana act itself expressly states that it does not require such reimbursement."

Finally, the court rejected claimant's argument that a workers' compensation insurer is not a health insurer for purposes of the statute. It noted that a significant aspect of workers' compensation is to provide reimbursement of medical expenses and associated health care payments. "Thus, entities who provide workers' compensation insurance are plainly providing health insurance benefits."

The court held that claimant's medical marijuana expenses are not compensable.

The case is *Wright's Case*, No. SJC-12873 (Mass. Oct. 27, 2020).

Nebraska Supreme Court Finds That Pollution Exclusion Bars Coverage for Loss Caused by Methamphetamine Production and Use in Rental Home

The Nebraska Supreme Court ruled that methamphetamine residue left behind after tenants vacated a rental home was "contamination." The owner's claim for property loss caused

by the tenants' smoking and production of the drug was therefore barred by the policy's pollution exclusion.

The Case

The insured, Jeremy Kaiser, owned real property in Omaha, Nebraska, that he maintained as a rental house. He carried an all risks rental insurance policy that covered direct physical loss to the property subject to certain exclusions. Under the pollution exclusion, there was no coverage for any property loss, consisting of or caused by, any type of vapors, fumes, acids, toxic chemicals, toxic gases, toxic liquids, toxic solids, waste materials, irritants, contaminants, or pollutants, including, "contamination."

In February 2013, Kaiser began receiving reports that the house was being used for drug-related activity. After his tenants voluntarily surrendered the property, Kaiser inspected the house and found evidence of methamphetamine. Kaiser retained a cleanup service to conduct preliminary tests of the house. The service discovered methamphetamine vapor and residue throughout the house and recommended that the house be decontaminated before it could be safely rented to new tenants.

Kaiser submitted a claim to his insurer, who denied coverage. Kaiser continued to remediate and decontaminate the house and then sued his insurer in Nebraska state court. The trial court granted the insurer summary judgment on the basis that the property loss was excluded from coverage under the policy's pollution exclusion. Kaiser appealed.

The Decision

The Nebraska Supreme Court affirmed. The court disagreed with Kaiser's contention that the pollution exclusion was ambiguous. As the word "contamination" was not defined in the policy, the court looked to common dictionaries for the plain and ordinary meaning of the word.

The Oxford English Dictionary defined contamination as "[t]he action of contaminating, or condition of being contaminated; defilement, pollution, infection." The court determined that the plain meaning of "contamination" included the loss for which Kaiser was seeking coverage.

The court also noted that in his briefs, Kaiser himself repeatedly referred to the property damage as "contamination" and his restoration efforts as "decontamination." The cleanup service Kaiser hired described the property loss similarly. In the court's view, "[t]his evidence goes to show that Kaiser, as the insured, reasonably interpreted the term' 'contamination' as encompassing the type of property damage he experienced."

The court also rejected Kaiser's alternative arguments. Kaiser had argued that other provisions of the policy provided coverage for sudden and accidental direct physical loss caused by fire resulting from vandalism or any act of a tenant that resulted in sudden and accidental direct physical loss caused by smoke. Kaiser argued that when there are two or more causes of loss to the covered property, coverage is only excluded if the "predominant" loss is excluded. Kaiser contended that his property loss was covered because it was predominantly caused by losses from fire resulting from vandalism or smoke caused by a tenant.

But the court found that Kaiser failed to show that his property loss was "sudden." It was unpersuaded by Kaiser's assertion that the loss was sudden because methamphetamine vapor and residue "quickly" bonded to most surfaces throughout the rental house. The property loss was not, in the court's opinion, each release of methamphetamine vapor and residue, but rather the loss that resulted from their many releases and for which Kaiser sought indemnification. The court therefore "decline[d] to embrace Kaiser's logic of death by a thousand paper cuts." Evidence in the record also showed that Kaiser's property loss occurred for more than a year. A reasonable

person in Kaiser's position, the court noted, would not understand "sudden" to refer to a property loss occurring over a period of time.

The court also found that it was immaterial under the policy whether the methamphetamine vapor and residue were released inside the house through production or through use.

For these reasons, the court concurred with the trial court's grant of summary judgment to the insurer and affirmed its order.

The case is *Kaiser v. Allstate Indem. Co*., No. S-19-858 (Neb. Oct. 23, 2020).

Claim Based on False Reporting of Coal Dust Samples Is Barred by Pollution Exclusion, Kentucky Federal District Court Holds

A federal court in Kentucky ruled that a pollution exclusion barred coverage for a claim arising out of false reporting of coal dust samples. In doing so, the court rejected the policyholders' contention that their liability was limited to fraudulent reporting and did not arise from the release or discharge of pollutants.

The Case

Employees of a coal company, Armstrong Coal Company, Inc., were indicted based on allegations relating to respirable dust sampling practices at the company's coal mine. Specifically, the U.S. Attorney for the Western District of Kentucky alleged that Armstrong and some of its employees obtained fraudulent samples during mining operations and submitted such sampling information to the Federal Mine Safety and Health Administration (MSHA).

Armstrong sought insurance coverage for the criminal investigation and action from its insurer, Arch Insurance Company. Arch had issued directors and officers liability coverage. Arch

denied coverage on the basis that, among other reasons, the policy's pollution exclusion barred coverage because coal dust constitutes a "solid contaminant and/or solid irritant."

Some of the Armstrong employees filed a lawsuit in Kentucky federal court against Arch seeking coverage for the federal criminal investigation and criminal action. The parties cross-moved for summary judgment. The Armstrong employees argued in part that because the underlying criminal charges against them were limited to fraudulently reporting dust monitoring and sampling requirements and didn't arise from the release or discharge of any pollutants into the environment, the pollution exclusion didn't apply.

The Decision

The court granted Arch's motion and denied the employees' motion.

Applying Kentucky law, the court held that the pollution exclusion barred coverage.

The court concluded that coal dust was a "pollutant" under the exclusion even though the coal dust was confined inside a coal mine "where it is supposed to be." The court noted that the definition of "pollutant" under the policies didn't depend on whether it left its intended location and caused some injury.

The court also rejected the employees' argument that the mere presence of coal dust in the mine didn't bar coverage unless there was an actual or threatened discharge of coal dust. The court noted that the pollution exclusion not only excluded losses for any claim arising from the threatened or actual release of pollutants, but also excluded any loss for any claim "arising from, based upon, or attributable to any" direction or request "to test for" or "monitor" pollutants under subparagraph (b) of the pollution exclusion. The court noted that whether any pollutants actually leaked was immaterial to whether the claims based on the underlying criminal allegations triggered subparagraph (b).

The court then held that subparagraph (b) of the pollution exclusion barred coverage of the employees' claims. The court noted that the indictment alleged that the employees conspired to commit dust fraud by knowingly and willfully altering the company's required dust-sampling procedures and submitting false samples. Thus, the court concluded, the criminal charges arose out of the direction from MSHA, via the regulations, to test and monitor coal dust to limit miners' exposure to coal dust.

For these reasons, the court granted the insurer's motion for summary judgment.

The case is *Barber v. Arch Ins. Co.*, 19-CV-00142 (W.D. Ky. Oct. 15, 2020)

North Carolina Federal Judge Finds That Hazardous Materials Exclusion Doesn't Bar Coverage for Direct Exposure Claims Involving Fire Suppressing Foam

A federal court in North Carolina ruled that a hazardous materials exclusion didn't bar coverage for bodily injury claims based on exposure to PFOA and PFOS in fire suppression foams because the underlying claims only partially involved prototypical environmental harms.

The Case

An insured manufacturer of fire equipment was sued in hundreds of cases for bodily injury and property damage caused by its product, aqueous film-forming foams (AFFF) – a fire suppressing foam. The underlying complaints alleged that AFFF contains man-made chemicals, including PFOA and PFOS, that are highly carcinogenic. About one-third of the underlying cases allege harm from both direct and environmental exposure.

The manufacturer had a general liability policy that required the insurer to defend against suits involving bodily injury or property damage. The policy contained a hazardous materials exclusion that barred coverage for those injuries "which would not have occurred *in whole or in*

part but for the actual, alleged, or threatened discharge, dispersal, seepage, migration, release or escape of 'hazardous materials' *at any time*." (emphasis added).

The insurer sought to get clear of the duty to defend and filed a declaratory judgment action in federal court in North Carolina. The insurer moved for summary judgment, contending that it had no duty to defend any of the underlying suits alleging direct and environmental exposure because of the hazardous materials exclusion. The manufacturer conceded that the insurer had no duty to defend any of the claims alleging solely environmental exposure but argued that the insurer had a duty to defend those claims alleging direct exposure.

The Decision

The court denied the insurer's motion for summary judgment and declared that it had a duty to defend the insured in the underlying litigation.

In reviewing North Carolina caselaw, the court observed that the terms "discharge, dispersal, release, or escape" are environmental terms of art. Any "discharge, dispersal, release, or escape" of a pollutant must be into the environment to trigger a pollution or similar exclusion. Thus, an insurer may not deny coverage to an insured on the basis of a pollution exclusion if the occurrence and resulting injury are not "prototypical environmental harms" that pollution exclusions are designed to protect against.

The court noted that the underlying complaints alleged personal injury caused by both traditional environmental pollution and direct contact with or exposure to AFFF. But the hazardous materials exclusion bars coverage for injuries that would not have occurred but for the "actual, alleged, or threatened discharge, dispersal, seepage, migration, release or escape of "hazardous material."

The court concluded that because the relevant underlying complaints alleged injury caused by something other than traditional environmental pollution, the insurer couldn't deny coverage with respect to the underlying claims alleging direct exposure.

The case is *Colony Ins. Co. v. Buckeye Fire Equip. Co.*, 19-cv-00534 (W.D.N.C. Oct. 20, 2020).

Assault and Battery Exclusion Bars Coverage for Claim Arising Out of Aggravated Vehicular Assault

A federal judge in the Southern District of Ohio found that an assault and battery exclusion unambiguously applied to injuries arising from any legally cognizable form of assault, and therefore, barred coverage for claims by patrons who were injured after a man purposely crashed his car into a sports bar.

The Case

A man stopped by Zapp's Sports Bar for a few drinks. Apparently, he had a few too many. After an altercation inside the bar, he left, got into his car, and drove it into the bar, seriously injuring a few patrons. The man pleaded guilty to aggravated vehicular assault and vandalism and was sentenced to prison for both charges.

The patrons sued the bar owner alleging negligent hiring and supervision and dram shop liability. The bar owner sought a defense under his commercial general liability policy. The policy had several exclusions, including an assault and battery exclusion. That exclusion provided as follows:

> This insurance does not apply to and we have no duty to defend any claims or "suits" for "bodily injury", "property damage" or "personal and advertising injury" arising in whole or in part out of:

a) the actual or threatened assault and/or battery whether caused by or at the instigation or direction of any insured, his employees, patrons or any other person;

b) the failure of any insured or anyone else for whom any insured is legally responsible to prevent or suppress assault and/or battery;

c) the negligent

(i) employment;
(ii) investigation;
(iii) supervision;
(iv) training;
(v) retention;

of a person for whom any insured is or ever was legally responsible and whose conduct would be excluded by (a) or (b) above.

d) any actual or alleged injury arises out of any combination of an assault and/or battery-related cause and a non-assault or battery-related cause;

e) any actual or alleged injury arises out of a chain of events which includes assault and/or battery, regardless of whether the assault and/or battery is the initial precipitating event or a substantial cause of injury;

f) any actual or alleged injury arises out of assault and/or battery as a concurrent cause of injury, regardless of whether the assault and/or battery is the proximate cause of injury; or

g) claims arising out of, caused by, resulting from, or alleging, in whole or in part, any insured's failure to thwart, foil, avoid, hinder, stop, lessen or prevent any attack, fight, assault and/or battery, theft, or crime.

The insurer denied coverage based on this exclusion given that the assailant pleaded guilty to aggravated vehicular assault. A declaratory judgment action followed.

The bar patrons contended in the declaratory judgment action that the exclusion was ambiguous and did not apply to a claim for aggravated vehicular assault, which does not require intent under Ohio's statutory law. They argued that the ordinary meaning of the term "assault" includes only the term's common law definition.

The Decision

The court disagreed. It found that the assault and battery exclusion applied to any bodily injury arising out of any legally cognizable form of assault, whether tortious or criminal. The term "assault" was not defined in the policy, but the court found that the term's plain and ordinary meaning encompassed both its common law and statutory definitions. Given that the man pleaded guilty to aggravated vehicular assault, the court found that the exclusion applied as a matter of law and awarded the insurer summary judgment.

The case is *Atlantic Cas. Ins. Co. v. Rutz,* No. 1:18-cv-00776 (S.D. Ohio Oct. 7, 2020).

Landlord's Liability Following Car Crash Arose from Restaurant's Use of Premises, Qualifying Landlord for Additional Insured Status and Entitling Insurer to Equitable Contribution, California Appellate Court Holds

Affirming the lower court's ruling, the California Court of Appeal found that a landlord, sued for failing to properly bolster its premises, qualified as an additional insured under a restaurant-tenant's insurance policy, where a car careened into the restaurant injuring two patrons. The court found that the landlord's liability arose out of the restaurant's "use" of the premises, because the "arising out of" language only required a minimal causal connection. The landlord's insurer, who defended and settled the claim, was therefore entitled to equitable contribution from the restaurant's insurer.

The Case

A couple was having dinner at the Holé Molé restaurant. They were injured when a car crashed through the front doors and pinned them to the wall. The car was propelled through the restaurant after having collided with another vehicle at a nearby intersection. The couple sued the

restaurant for failing to take precautionary measures that would safeguard the wellbeing of its patrons. The restaurant had a liability policy with AMCO Insurance Company, who defended the restaurant in the lawsuit.

The couple later added the landlord to the suit as well. They claimed that after a similar accident a few years earlier, the landlord should have protected the property by reinforcing the front door frame or by installing bollards to prevent a vehicle from entering the premises. The landlords sought a defense from their insurer, Truck Insurance Exchange. Truck tendered the claim to AMCO based on an indemnity provision in the restaurant's lease with the landlord.

AMCO denied owing any defense or indemnity to the landlord because the restaurant was not responsible for the out of control vehicle or the absence of bollards on the property. AMCO argued that the loss did not arise out of the restaurant's use or occupancy of the premises.

The restaurant and landlord both moved for summary judgment in the underlying action. The restaurant prevailed but the landlord did not. The court found that the restaurant had no knowledge of the prior accident and was not authorized to alter the premises without the landlord's consent. In contrast, the court found that the landlord knew of the previous incident and had "moral blame" for not doing anything to prevent a similar accident from occurring to the property. Truck then settled the action on behalf of the landlord for $785,000.

Truck next sought equitable subrogation, equitable indemnification, and equitable contribution from AMCO, pointing to the indemnity clause in the lease, as well as the requirement that the landlord be named as an additional insured under the restaurant's general liability policy. The additional insured provision under the AMCO policy stated: "Any person or organization from whom you lease premises is an additional insured, but only with respect to their liability arising out of your use of that part of the premises leased to you." Truck argued that this condition was

met because the couple would not have been present as patrons or injured but for the use of the property as a restaurant.

AMCO argued that the couple's premises liability action was based on the landlord's breach of its non-delegable duty to maintain safe premises and its knowledge of a prior similar incident. AMCO said that its policy did not cover the landlord for liability arising out of its building that had no connection to the restaurant's operation. Also, the lease did not require the restaurant to indemnify the landlord for the landlord's active negligence. Liability, AMCO argued, did not arise out of the restaurant's use of the premises, but rather, the landlord's knowledge of the prior accident and negligent reconstruction of the building.

The trial court rejected AMCO's arguments finding that the lawsuits arose out of the injured couple having been patrons of the restaurant. The trial court further found that equitable contribution applied and required AMCO to split defense costs and the settlement amount equally with Truck. AMCO appealed.

The Appellate Court's Decision

The California Court of Appeal affirmed.

The court first noted that if the landlord qualified as an additional insured under AMCO's policy, then Truck was entitled to equitable contribution. It then considered if the landlord's liability arose out of the restaurant's use of the premises.

The court observed that California courts have broadly interpreted the terms "arising out of" or "arising from." Such language "broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incident relationship." The court concluded that the landlord's liability did in fact arise from the restaurant's use of the premises. It reasoned that the couple was present when the accident occurred because they were customers

of the restaurant. If the premises were not being used as a restaurant, they would not have been there. The court emphasized that only a minimal causal connection was required to trigger coverage under the "arising out of" clause.

AMCO also argued that the award of summary judgment to the restaurant in the underlying case demonstrates that the landlord's liability did not arise out of the use of the premises as a restaurant. But the court rejected this argument because the additional insured endorsement did not rely on the relative liabilities of the parties. The court said that AMCO did not write its additional insured endorsement to bar coverage where the tenant was not at fault. Instead, the endorsement referred only to the landlord's liability arising out of the tenant's use of the property. The named insured's negligence, or lack thereof, is irrelevant, the court reasoned, when the additional insured endorsement does not purport to allocate or restrict coverage according to fault.

The court concluded that because the landlord's liability arose from the restaurant's use of the premises, the landlord was an additional insured under the AMCO policy, and Truck was therefore entitled to equitable contribution.

The case is *Truck Ins. Exch. v. AMCO Ins. Co.,* No. B298798 (Cal. Ct. App. Oct. 26, 2020).

Federal Court in Hawaii Finds No Coverage Under CGL Policy for Defective Work Claim

A federal court in Hawaii ruled that an insurer had no duty to defend or indemnify a contractor under a commercial general liability policy for a claim based on a leaking interior pond caused by the contractor's defective work.

The Case

Charles Somers had an ownership interest in Kilauea Falls Ranch located on the island of Kaua'i, Hawai'i. Somers entered into a contract with RMB Enterprises, Inc. d/b/a Paradise Pacific Homes on January 28, 2011 for the development and construction of the property, which included residential structures and a pond. RMB built the property from 2011 to 2013.

In February 2017, the pond leaked into its pump room and RMB performed remedial work by injecting epoxy into cracks. On June 3, 2017, water from the pond leaked into the interior of the residence near a staircase. Water also leaked into the master bedroom area causing musty odor, mold growth, and increased humidity. Somers incurred substantial expenses investigating the sources of the leaks and discovered water proofing issues and the use of untreated lumber in violation of the building code. Additional leaks appeared in December 2017 in the pump room and at the base of an exterior wall between the main residence and the pump room.

Somers filed the underlying action in Hawaii state court on November 14, 2018, asserting breach of contract, breach of warranty, misrepresentation, and negligence claims.

RMB's insurer defended RMB in the underlying action pursuant to a reservation of rights. The insurer maintained that there was no "occurrence" under the policy because there was no accident or damage to property other than the contractor's work.

The insurer brought a declaratory judgment action in federal court in Hawaii for a determination that it had no duty to defend or indemnify RMB in the underlying action. It then moved for summary judgment.

The Decision

The court granted the insurer's motion. Applying Hawaii law, the court noted that CGL policies don't provide coverage to contractors and developers for claims alleging that their work is

inferior or defective. Otherwise, the court noted, CGL policies would be converted into professional liability policies or performance bonds. The court observed that the underlying claims were clearly predicated on the contractual relationship between RMB and Somers, and therefore, were not “accidents” under the CGL policies.

The court held that faulty workmanship does not constitute an “occurrence.” RMB, however, tried to persuade the court that there was coverage by pointing to an exception to an exclusion. An exception exists: "when faulty workmanship performed by you or on your behalf . . . causes 'property damage' to property other than 'your work', then such . . . 'property damage' will be considered caused by an 'occurrence'." The policy defined "Your work" as "(1) Work or operations performed by you or on your behalf; and (2) Materials, parts or equipment furnished in connection with such work or operations," and includes "(1) Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of 'your work', and (2) The providing of or failure to provide warnings or instructions."

The court found that this exception was inapplicable because the damages in the underlying action were limited to the pond and residence, both of which RMB constructed. It was undisputed that RMB performed work for the entire property and furnished materials parts, or equipment in connection with such work. The court rejected RMB’s effort to manufacture a distinction between the pond and the residence. Even if the pond and residence were independent of one another, the court noted, the dispositive inquiry is whether RMB caused property damage to property other than its work. The underlying complaint alleged that RMB caused property damage to its own work. Thus, the assertion of faulty workmanship was not an “occurrence.”

For these reasons, the court concluded that RMB was not entitled to coverage under the policies and the insurer had no duty to defend or indemnify RMB.

The case is *Nautilus Ins. Co. v. RMB Enters.*, Civ. No. 19-00496 (D. Haw. Oct. 28, 2020).

North Carolina State Court Finds That Restaurant Groups' Lost Business Income Caused by Covid-19 Lockdowns Constitutes a Covered Direct Physical Loss

A North Carolina state court, bucking the national trend, found that a restaurant groups' lost business income caused by Covid-19 lockdowns constituted a covered direct physical loss under the groups' all risk property insurance policies.

The Case

Sixteen restaurant operators in North Carolina sought coverage under their all risks property insurance policies for losses arising out of governmental mandated lockdowns in response to the Covid-19 pandemic. The restaurants sought a declaratory judgment that their insurer, the Cincinnati Insurance Company, was obligated to pay their lost business income and extra expenses.

The policies at issue provided business interruption coverage for actual loss of "Business Income" and "Rental Value" sustained due to the necessary "suspension" of the insured's "operations" during the "period of restoration." The policies stated that the "suspension" must be caused by direct "loss" to property at a premises caused by or resulting from a covered loss. The policies defined "loss" to mean "accidental physical loss or accidental physical damage."

The restaurants filed suit in North Carolina state court and moved for partial summary judgment on liability. The restaurants argued that government lockdowns forced them to lose the

physical use of and access to their property and premises, which constituted a non-excluded "direct physical loss."

The Decision

The court granted the restaurants' motion.

Because the terms "direct," "physical loss," and "physical damage" were not defined in the policy, the court resorted to dictionary definitions to inform their meaning. The court concluded that the ordinary meaning of the phrase "direct physical loss" included the inability to utilize or possess something in the real, material, or bodily world. The court found that "direct physical loss" described a scenario where businessowners and their employees, customers, vendors, suppliers, and others lose the full range of rights and advantages of using or accessing their business property. In the court's view, that was precisely the loss caused by the Covid-19 lockdowns in North Carolina. As the court noted, the restaurants were expressly forbidden by government decree from accessing and putting their property to use for the income-generating purposes for which the property was insured.

The court rejected Cincinnati's argument that the policies didn't provide coverage for pure economic harm in the absence of direct physical loss/alteration to property. The court found that Cincinnati's view that a loss required physical alteration conflated "physical loss" and "physical damage." The court reasoned that if "physical loss" and "physical damage" required structural alteration to property, the distinct term "physical damage" would be meaningless.

Having found that nothing in the policies excluded virus-related causes of loss, the court granted the restaurants' motion and concluded that the policies covered business income and extra expenses for their loss of use and access to covered property caused by government-mandated Covid-19 lockdowns.

The case is *North State Deli, et al. v. The Cincinnati Ins. Co.*, 20-CVS-02569 (N.C. Sup. Ct., Durham Cty., Oct. 9, 2020).