January 8, 2014

Voluntary Payments Clause Bars Contractor's Claim for Construction Damage

Most insureds recognize that insurance policies only cover particular types of losses. Many insureds, however, may not realize that an insurance company has no obligation to pay even a covered loss if the insured fails to comply with specific conditions stated in the policy. The most recent insurance case from the Fourth Circuit Court of Appeal reminds us that even multi-million dollar claims of sophisticated businesses can be lost when the resolution of a business dispute trigger the voluntary payment and no-action conditions of a commercial general liability (CGL) policy.

CGL insurers have the right to defend suits against the insured, to investigate an occurrence, and to settle claims and suits that may result from an occurrence. These rights are broad and terminate only after the company makes a payment of policy limits for judgments or settlements. Because the insurer holds these rights, an insured who resolves an occurrence, claim or suit without the input and consent of the insurer likely will surrender its ability to seek coverage for that matter through operation of the "voluntary payment" and "no action" conditions. A typical voluntary payment clause provides "No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than for first aid, without [the insurer's] consent." To underscore that limitation, a no-action clause commonly provides that an insured cannot sue the insurer for coverage "unless all of its terms have been fully complied with" and that a policyholder's "settlement payments can be recovered only if the insurer itself has signed the settlement and release of liability."

These clauses eliminated coverage for a substantial construction loss in the recent case of *Perini/Tompkins Joint Venture v. Ace American Ins. Co.*, 2013 WL 6570947 (4th Cir. Dec. 16, 2013). The case arose out of the construction of the Gaylord Hotel and Convention Center in National Harbor. PTJV, the insured, was the general contractor for the $900 million project and ACE provided insurance coverage through an Owner Controlled Insurance Program ("OCIP"). The Project also was insured through a builder's risk policy issued by FM Global.

During construction of the hotels' impressive 18-story glass atrium, a truss joint failed and substantially impaired the structural integrity of the atrium. An ACE representative was on-site at the time of the failure. The truss failure caused damage to other portions of the Project as well as a temporary suspension of work and a completion delay. After completion, PTJV sued the Project Owner for final payment of $79 million. The Owner countersued, seeking $65

million in alleged overpayments, delays, and failure to build a high quality product at the contract price. A few months after the suits began, the parties settled. PTJV provided a $26 million credit and the Owner paid an additional $42 million. PTJV never sought to obtain ACE's consent prior to entering into the settlement.

About six months after the settlement and two years after the truss failure, PTJV for the first time contacted ACE to seek reimbursement for the failure to the extent the builder's risk policy did not provide coverage. The letter did not mention the settlement with the Owner. Over ten months later, ACE issued a reservation of rights letter citing, among other things, the voluntary payment and no action clauses as grounds to deny coverage. After a brief period of negotiation, PTJV sued ACE for coverage and ACE moved to dismiss the case.

The Court's analysis was straightforward. The policy contained unambiguous right to defend, voluntary payment, and no action clauses. Adopting ACE's characterization of the claim, the Court agreed that "[t]he central issue in this appeal is whether the insured ... can unilaterally settle a construction defect case ..., present the settlement to its liability insurer as a *fait accompli,* and obtain indemnification despite its blatant breach of clear and unambiguous policy provisions." The Court answered that question with "no."

The Court found that the no-action clause plainly sated that the insured could not sue "*unless* all of its terms have been fully complied with." The clause also stated that the insured could recover a settlement payment only if the "settlement and release of liability" was "signed by [ACE]." The Court also drew upon the voluntary payment clause, which required ACE's consent before "voluntarily mak[ing] a payment, assum[ing] any obligation, or incur[ring] any expense." These clauses were conditions precedent to any coverage obligation of ACE. Because PTJV did not meet these requirements but, instead, settled issues relating to the atrium failure without notice to or consent of ACE, ACE had no obligations under the policy.

The Court rejected PTJV's argument that a Maryland statute (Md. Code Sec. 19-110) or the common law required ACE to demonstrate actual prejudice before it could deny coverage. First, the Court found the statute applicable only to lack of notice issues, not the failure to meet the conditions precedent of the voluntary payment and no-action clauses. Moreover, even if prejudice was required by statute or by common law, the Court relied on prior law holding that prejudice could be presumed as a matter of law. By settling without notice, the policyholder unilaterally nullified the insurer's right to investigate, defend, control or settle the claim. This result prejudiced the insurer as a matter of law as it was put "in a position of proving a negative and speculating about what could have been."

In deference to a choice of law dispute between the parties, the Court analyzed the issue under Maryland and Tennessee law. It found, however, that the outcome was the same under either state's law. The result is not surprising, as most courts require strict adherence to voluntary payments clauses and consistently apply the no-action clause to bar coverage.

PTJV demonstrates that business disputes easily can bleed over into insurance issues. Prompt settlements often are cost-effective and prudent business decisions. Where insured – or possibly insured – losses are involved, however, the decision makers need to evaluate the reward of the settlement against the risk of losing coverage. Often, strategies can be employed to lessen the risk while minimizing the impact on the possible benefit of a suit or settlement. Clear communication with the insurer, standstill agreements, carve-outs, and escrows are some ways of trying to preserve coverage while moving ahead with intertwined business issues. In all cases, however, the insurance company needs to be apprised and involved in the process to avoid the application of conditions such as the voluntary payment and no-action clauses.

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