Simpson Thacher

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Montana Court Rules That Carbon Monoxide Claims Allege A Single Occurrence Under Cause-Based Test

A Montana federal district court ruled that underlying claims stemming from carbon monoxide poisoning alleged only one occurrence as a matter of law. *Western National Mutual Ins. Co. v. Rainbow Ranch Holdings, LLC*, 2023 U.S. Dist. LEXIS 207868 (D. Mont. Nov. 17, 2023). (Click here for full article)

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Illinois Supreme Court Addresses Scope Of General Liability Coverage For Construction Defect Claims

HOLDING

The Illinois Supreme Court ruled that allegations in a construction defect suit fell within the initial grant of coverage in a general liability policy for purposes of triggering the insurer's duty to defend, but remanded the matter for a determination of whether policy exclusions barred coverage. *Acuity v. M/I Homes of Chicago, LLC*, 2023 Ill. LEXIS 1019 (Ill. Nov. 30, 2023).

BACKGROUND

A townhome owners' association sued M/I Homes, the general contractor and developer and seller of the homes. The suit alleged that M/I Homes's subcontractors performed faulty workmanship and used defective materials, resulting in property damage. M/I Homes sought a defense from Acuity under a general liability policy issued to one of the subcontractors and under which M/I Homes was an additional insured. Acuity denied coverage and filed a declaratory judgment action, arguing that the underlying complaint did not allege "property damage" caused by an "occurrence," as required by the policy.

Ruling on the parties' cross-motions for summary judgment, the trial court held that Acuity had no duty to defend. The trial court reasoned that property damage resulting from faulty workmanship was not an "occurrence" because it was a natural and ordinary consequence of negligent work, rather than an accident. The trial court also held that there was no "property damage" because only the townhomes themselves were damaged, and that "property damage" requires damage to property aside from the project itself. The appellate court reversed, ruling that a liberal construction of the allegations in the complaint alleged "property damage" caused by an "occurrence," and that Acuity therefore had a duty to defend.

DECISION

The Illinois Supreme Court reversed in part and affirmed in part. With respect to whether the policy's initial grant of coverage encompassed the underlying allegations so as to give rise to a duty to defend, the Illinois Supreme Court affirmed the appellate court's decision. In particular, the Illinois Supreme Court held that allegations of water damage due to leaks arising from faulty construction and/or defective materials constituted "property damage." The court expressly rejected the notion that property damage requires damage to property beyond the townhome construction project itself, noting that such reasoning is not grounded in policy language.

Additionally, the court held that the claims alleged an "occurrence," defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Emphasizing that an accident is generally understood to mean "an unforeseen occurrence" or "an undesigned, sudden, or unexpected event," the court concluded that "accident" reasonably encompasses the unintended and unexpected damage caused by negligent construction.

However, the Illinois Supreme Court reversed the appellate court's decision insofar as it granted summary judgment in favor of M/I Homes. The Illinois Supreme Court noted that policy exclusions relating to "Expected or Intended Injury" and "Business Risks Including Damage to Property and Damage to Your Work" might operate to bar coverage, and remanded the matter for resolution of those issues.

COMMENTS

Ruling on this matter of first impression under Illinois law, the court acknowledged the lack of consistency on rulings in this context, both within Illinois and across jurisdictions. As the court noted, courts have considered a variety of factors in determining whether construction defect suits give rise to general liability coverage,—some of which are not derived from governing policy language—including whether the damage was to property other than the defective work itself and whether the insured was a contractor or subcontractor. With respect to Illinois appellate court decisions holding that "property damage" requires damage to property other than the construction project itself, the court expressly rejected those decisions, stating that such cases "should no longer be relied on."

Arbitration Panel, Not Court, Must Determine Preclusive Effect Of Prior Arbitration Award On A Subsequent Arbitration, Says Illinois Court

HOLDING

An Illinois district court granted a motion to compel arbitration, ruling that the question of whether a prior arbitration award has preclusive effect on a subsequent arbitration is a matter for the arbitration panel to decide, not a court. *National Cas. Co. v. Cont'l Ins. Co.*, 2023 U.S. Dist. LEXIS 204528 (N.D. Ill. Nov. 15, 2023).

BACKGROUND

Continental entered into three reinsurance agreements with National Casualty and Nationwide. When a dispute relating to the reinsurers' billing arose in 2017, Continental initiated arbitration proceedings against each reinsurer pursuant to an arbitration clause in the agreements. Both arbitration proceedings resulted in final awards that were confirmed by Illinois district courts.

The current dispute arose out of the same provision in the reinsurance agreements. Once again, Continental initiated arbitration against the reinsurers who, in turn, filed suit seeking to preclude Continental from re-arbitrating the final decisions of the 2017 arbitrations. The reinsurers asked the court to stay arbitration in order to allow the parties to litigate the preclusive effect of the prior arbitration. In response, Continental moved to compel arbitration and to dismiss the case. The court granted Continental's motion and denied the reinsurers' motion.

DECISION

As the court noted, while broad arbitration provisions, such as the one at issue here, require the parties to resolve any dispute relating to the agreement in an arbitration proceeding, a narrow exception exists for a "question of arbitrability." However, this exception is narrow in scope, limited to "gateway matters," such as whether non-signatories

may be bound by an arbitration clause. The court rejected the reinsurers' assertion that the preclusive effect of a prior judgment constituted one such "threshold question" of arbitrability. The court explained that a determination of the preclusive effect of the 2017 awards would require an assessment of the merits of the claims and the substantive prerequisites for collateral estoppel and was therefore not a "threshold question of arbitrability" that was subject to judicial ruling.

The court also rejected the reinsurers' contention that Section 13 of the Federal Arbitration Act (which states that an arbitration award "shall have the same force and effect, in all respects, as, and be subject to all the provisions of law relating to, a judgment in an action; and it may be enforced as if it had been rendered in an action in the court in which it is entered") required the court to adjudicate the preclusive effect of an arbitration award that has been confirmed by a court. The court noted the lack of Seventh Circuit support for this assertion, as well as the First and Ninth Circuits' rejection of this argument.

COMMENTS

The decision reinforces the well-established principles that "disputes are presumed arbitrable" where a contract includes a broad arbitration clause and that exceptions to this rule are limited in scope. Courts across jurisdictions have held that various procedural defenses—including issues of waiver, delay, notice and laches, among other things—are not "gateway" matters subject to the narrow exception, but rather are matters to be decided by an arbitration panel.

In contrast, questions relating to whether a non-signatory may be bound by an arbitration clause have been deemed gateway matters appropriate for resolution by a court. In a decision issued this month, the Second Circuit denied a motion to compel arbitration, ruling that a non-signatory to a reinsurance agreement was not obligated to arbitrate under a "direct benefits estoppel" theory, which precludes a non-signatory from obtaining benefits from a contract while avoiding an arbitration provision in that same contract. *Travelers Indem. Co. v. Grapeland Independent School Dist.*, 2023 U.S. App. LEXIS 32631 (2d Cir. Dec. 11, 2023).

Hawaii Supreme Court Rules That Insurer May Not Recover Defense Costs From Insured Absent Express Policy Provision

HOLDING

The Hawaii Supreme Court ruled that an insurer that has defended an insured may not subsequently seek equitable reimbursement of defense costs unless an express policy provision affords that right. *St. Paul Fire & Marine Ins. Co. v. Bodell Construction Co.*, 2023 Haw. LEXIS 194 (Haw. Nov. 14, 2023).

BACKGROUND

This dispute arose from the allegedly negligent construction of a residential development, which resulted in a lawsuit against a subcontractor involved in the project. The subcontractor tendered defense of the suit to several primary and excess policies under which it was listed as an additional insured. The insurers agreed to defend under a reservation of rights, which included a statement reserving the insurers right to seek reimbursement for fees and costs related to claims not potentially covered under the policies.

The underlying suit was stayed pending two arbitrations. An arbitration between the subcontractor and the claimant resulted in a settlement agreement, and an arbitration between the subcontractor and general contractor resulted in an arbitration award against the general contractor. The award was confirmed by a Hawaii court and a judgment was issued in favor of the subcontractor.

Thereafter, the insurers filed suit, seeking reimbursement of costs incurred in defending the underlying suit. The district court certified the following question to the Hawaii Supreme Court:

> Under Hawaii law, may an insurer seek equitable reimbursement from an insured for defense fees and costs when the applicable insurance policy contains no express provision for such reimbursement, but the insurer agrees to defend the insured subject to a reservation of rights, including reimbursement of defense fees and costs?

The Hawaii Supreme Court answered this question in the negative.

DECISION

The court provided three main rationales for its decision. First, the court emphasized that contractual language unequivocally governs the parties' rights and obligations, and that the policy was silent as to a right to reimbursement of defense costs. The court rejected the notion that a reservation of rights alters those rights, stating: "Insurers may reserve contractual rights, not create new ones." Second, the court reasoned that reimbursement would erode the broad duty to defend. The court noted that an insurer's duty to defend is determined at the outset, based on allegations in the complaint, and that allowing reimbursement at a later date "would effectively require that insurers only defend to the same extent that they must ultimately indemnify." (Citations omitted). Finally, the court ruled that an insured is not unjustly enriched by receiving a defense for claims outside the scope of coverage. The court explained that by providing a defense, the insurer retains the benefit of strategic control over the litigation and that allowing reimbursement would unjustly enrich the insurer.

COMMENTS

Courts in other jurisdictions are split on this issue. While some jurisdictions, such as California, allow insurers to recoup defense costs under certain circumstances, others, such as Pennsylvania, do not. Courts that have allowed reimbursement have employed various reasoning, including that the reservation of rights creates an implied contractual right to such reimbursement and/or that denying reimbursement would result in unjust enrichment to the insured.

Illinois Appellate Court Rejects Seventh Circuit's Reasoning And Holds That Coverage For BIPA Claims Is Barred By Policy Exclusion

HOLDING

An Illinois appellate court ruled that general liability insurers were not obligated to defend a suit alleging violations of the Biometric Information Privacy Act ("BIPA"), expressly rejecting a recent Seventh Circuit ruling that reached the opposite conclusion. *National Fire Ins. Co. of Hartford v. Visual Pak Co., Inc.*, 2023 Ill. App. LEXIS 482 (Ill. App. Dec. 19, 2023).

BACKGROUND

The underlying BIPA suit arose out of a company policy that involved the collection of employees' fingerprints to monitor daily working hours. The company tendered defense of the suit to its general liability and umbrella insurers, who denied coverage and sought a declaration that they had no duty to defend or indemnify the BIPA claims. The trial court initially ruled that questions of fact existed as to whether the company was entitled to coverage, but upon reconsideration, granted the insurers' motion for judgment on the pleadings. The appellate court affirmed.

DECISION

The appellate court held (and the insurers did not contest) that the BIPA claims fell within the policies' initial grant of "personal and advertising injury" coverage, which encompassed injuries arising out of "[o]ral or written publication, in any manner, of material that violates a person's right of privacy." The controversy centered on whether a policy exclusion barred coverage for the claims. The exclusion, titled "Recording And Distribution Of Material Or Information In Violation Of Law," stated that coverage did not apply to:

> Personal and advertising injury arising directly or indirectly out of any action or omission that violates or is alleged to violate:
>
> (1) The Telephone Consumer Protection Act (TCPA), including any amendment of or addition to such law; or
>
> (2) The CAN-SPAM Act of 2003, including any amendment of or addition to such law;
>
> (3) The Fair Credit Reporting Act (FCRA), and any amendment of or addition to such law, including the Fair and Accurate Credit Transactions Act (FATCA); or
>
> (4) Any federal, state, or local statute, ordinance or regulation, other than the TCPA, CAN-SPAM Act of 2003 or FCRA and their amendments and additions, that addresses, prohibits, or limits the printing, dissemination, disposal, collecting, recording, sending, transmitting, communicating or distribution of material or information.

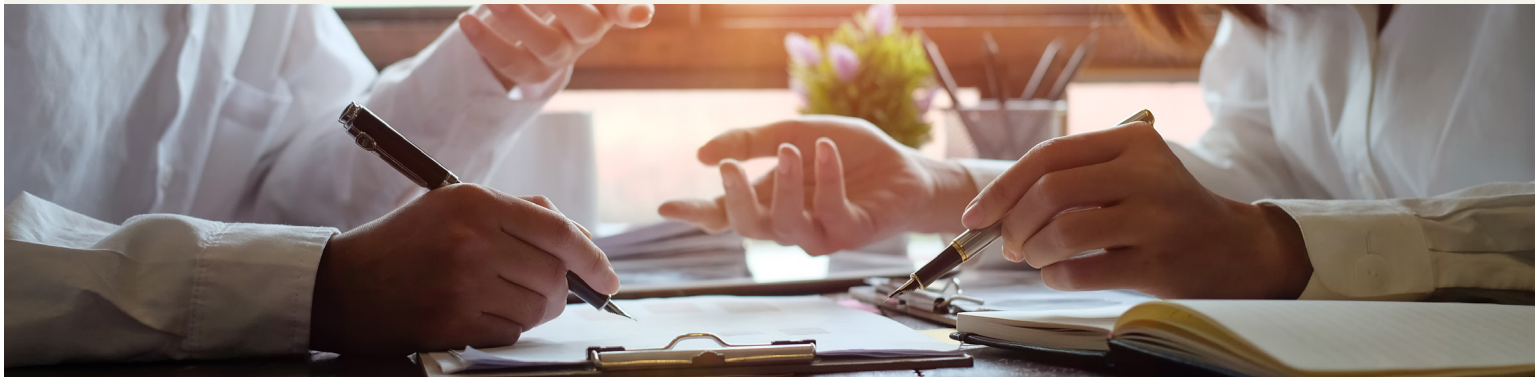
As the appellate court noted, decisions involving the same exclusionary language as that presented here are divided as to whether the "catch all" sub-section encompasses BIPA claims. In a recent decision, the Seventh Circuit held that nearly identical language did not preclude a duty to defend, abrogating several federal district court decisions that found similar exclusions applicable to BIPA Claims. *See Citizens Ins. Co. of Am. v. Wynndalco Enterprises, LLC*, 70 F.4th 987 (7th Cir. 2023) (discussed in our June 2023 Alert).

In *Wynndalco*, the Seventh Circuit acknowledged that a plain-text reading of the catch all provision would include BIPA violations, but nonetheless concluded that the provision was ambiguous because a liberal reading of it would exclude from coverage injuries or damage arising from a large category of intellectual property claims that the policy by its express terms otherwise purported to cover. The Seventh Circuit also held that the interpretative cannon of *ejusdem generis*, under which broad or general contract terms are construed according to the specific terms that precede them, did not resolve the ambiguity because there was no "readily discernible theme" of privacy in the exclusion.

The Illinois appellate court expressly rejected the Seventh Circuit's reasoning, noting that it "gave too little credit to the reasonable person purchasing this business liability policy" in concluding that a theme of personal privacy among the statutes listed in the exclusion was not readily apparent. The court expressly disagreed with the Seventh Circuit's reasoning and holding as to ambiguity, deeming it inconsistent with Illinois law. In particular, while the Illinois appellate court agreed with the Seventh Circuit's proposition that an insurer's interpretation of an exclusion will not be adopted if it would altogether eliminate coverage, the court deemed that principle inapplicable here, where "the exclusion at issue does not come close to wholly erasing the insured's coverage." The court also took issue with Seventh Circuit's invocation of other contract provisions that were not implicated in the coverage dispute (such as those relating to coverage for copyright and trade dress claims) in order to deem the exclusion ambiguous. The Illinois appellate court stated:

> [T]he Seventh Circuit's point establishes, at most, that the catch all exclusion might irreconcilably conflict with a few provisions of the "personal and advertising injury" coverage. That may be so, but these provisions are not at issue in this case. . . . We are aware of no authority in Illinois law, nor did the Seventh Circuit cite any, for the proposition that a hypothetical conflict in language that was not at issue before the court could permit the court to essentially nullify an entire coverage exclusion as illusory, even though there is no such conflict between the coverage and exclusion provisions at issue in the case before the court.

As such, the court deemed *Wynndalco* wrongly decided and ruled that the insurers owed no duty to defend the underlying BIPA claims in the present case.



COMMENTS

The court also distinguished *West Bend Mutual Ins. Co. v. Krishna Schaumburg Tan, Inc.*, 2021 Ill. LEXIS 430 (Ill. May 20, 2021) in which the Illinois Supreme Court ruled that a similar exclusion did not bar coverage for BIPA claims. As the court noted, the exclusion in *West Bend* differs from that in the present case in several important respects. Most notably, the catch all provision in the *West Bend* exclusion references only "sending, transmitting, communicating or distribution" of material, whereas the catch all provision in this case includes those terms, as well as "disposal, collecting [and] recording." The court explained that inclusion of these additional terms "undoubtedly broaden[s]" the scope of the exclusion at issue here. Further, the court noted the title of the exclusion in *West Bend* ("Violation of Statutes That Govern E-Mails, Fax, Phone Calls or Other Methods of Sending Material or Information") speaks exclusively to modes of communication, whereas the exclusion title in this case ("Recording And Distribution Of Material Or Information In Violation Of Law") suggests a more expansive scope by virtue of the word "Recording," which contemplates the collecting and retaining of information for future use. Finally, the court noted that the inclusion of only the TCPA and the CAN-SPAM Act of 2003 in the *West Bend* exclusion indicates an intent to limit application of the catch all provision to statutes that likewise govern unsolicited communication. In contrast, the exclusion here also lists the FCTA and FACTA, statutes that relate more generally to the privacy of personal information.

The decision also highlights the limits of a policyholder's estoppel argument. Here, the policyholder had also argued that the insurers were estopped from denying coverage by virtue of an alleged delay in denying coverage. The court explained that under the doctrine of estoppel, if an insurer fails to issue a reservation of rights or alternatively seek a declaration that it has no duty to defend, it may subsequently be estopped from asserting defenses to coverage. However, estoppel has no application where, as here, a court has determined there is no duty to duty to defend in the first place. As the court noted, to hold otherwise "would be to give estoppel the power to magically rewrite a policy from one that does not obligate the insurer to defend into one that does."

Montana Court Rules That Carbon Monoxide Claims Allege A Single Occurrence Under Cause-Based Test

HOLDING

A Montana federal district court ruled that underlying claims stemming from carbon monoxide poisoning alleged only one occurrence as a matter of law. *Western National Mutual Ins. Co. v. Rainbow Ranch Holdings, LLC*, 2023 U.S. Dist. LEXIS 207868 (D. Mont. Nov. 17, 2023).

BACKGROUND

The underlying claimants were exposed to carbon monoxide while staying at a Montana hotel, resulting in injuries to one individual and the death of another. The hotel was insured under a general liability policy and an umbrella policy, both issued by Western National. The general liability policy had a $1 million per-occurrence limit with a medical expense limit of $10,000 per person and the umbrella policy had a $5 million limit. Western National tendered the policy limits of $6,020,000 and sought a declaration that the underlying suit alleged only one occurrence.

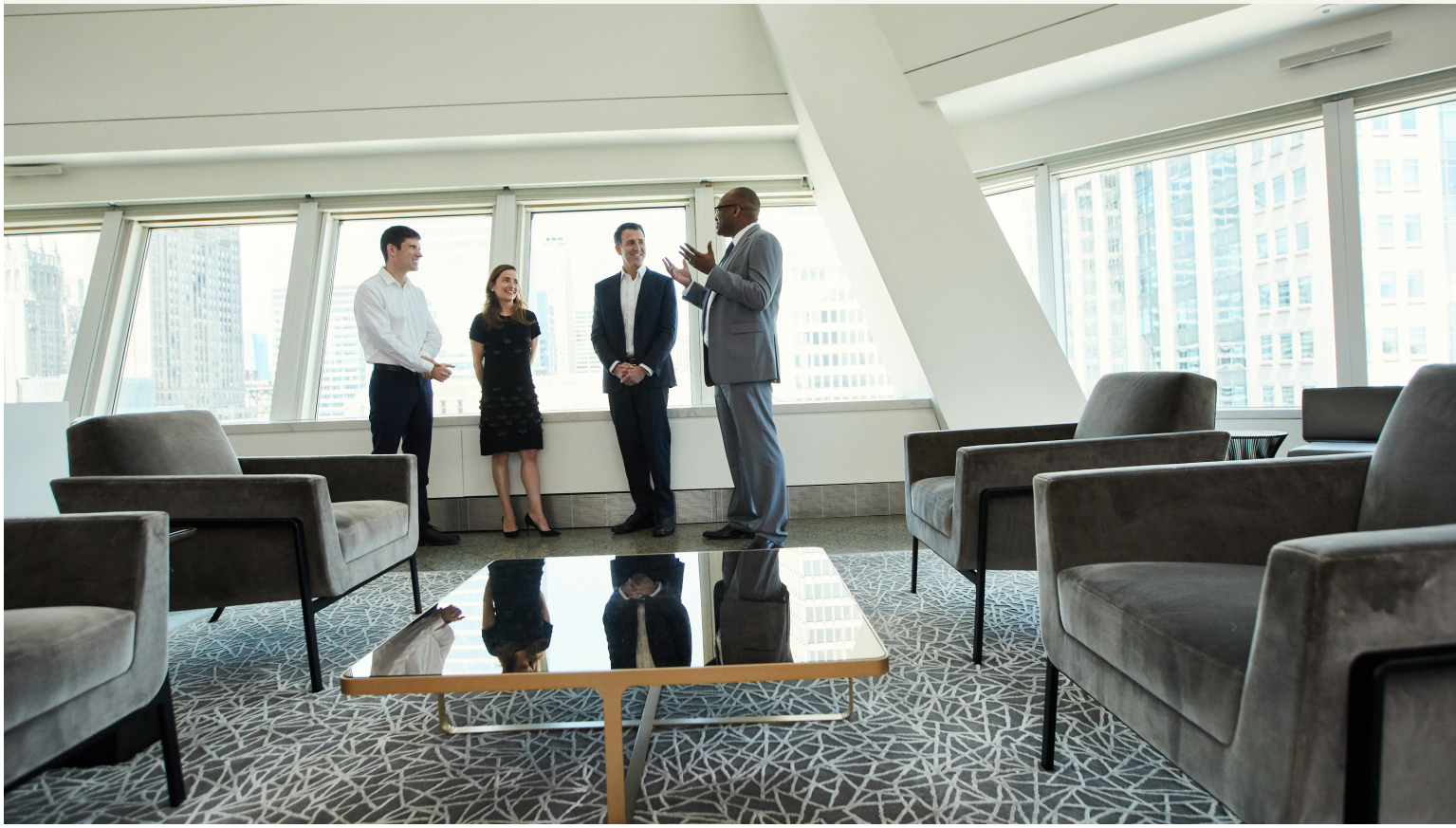
DECISION

The court ruled in Western National's favor, finding that the underlying claims alleged a single occurrence under Montana's cause-based test for determining the number of occurrences. The court acknowledged that the underlying complaint alleged several distinct

negligent acts, including the failure to warn, the failure to maintain and faulty construction of the hotel room, but nonetheless concluded that "the sole cause" for the claimants' injuries and death was the carbon monoxide poisoning. As the court noted, courts in other jurisdictions have similarly ruled that injuries stemming from carbon monoxide exposure, even if the result of several contributing factors, stem from a single occurrence.

COMMENTS

Aside from the number-of-occurrences ruling, the court also addressed an argument relating to whether the case presented a justiciable controversy. The hotel argued that the court should dismiss the suit as unripe or stay the matter pending resolution of the underlying litigation. The hotel claimed that "considering whether policy limits exceed $6 million involves a hypothetical and academic practice because it remains unknown whether a jury would reach a verdict over $6 million." Rejecting this argument, the court explained that the number-of-occurrences question determines whether Western National owes additional coverage (*i.e.*, additional per-occurrence payments based on multiple occurrences), which affect its good faith obligations. Notably, the court distinguished the case from decisions holding that an insurer's declaratory judgment action relating to its duty to indemnify is not ripe for adjudication until the question of underlying liability against the insured is resolved.



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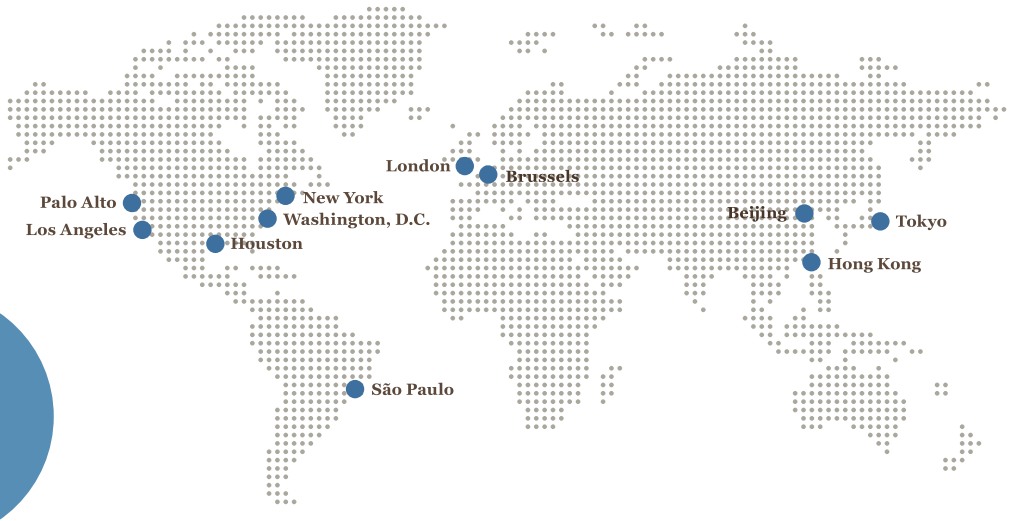

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