

Special Bulletin

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California Court of Appeal Reverses Trial Court's Finding that Prior Damages Exclusion is Ambiguous

by Linda Tai Hoshide and Mohammed S. Mandegary

On April 8, 2009, the California Court of Appeal, in an unpublished decision, *Golden Eagle Insurance Corporation v. Gerling America Insurance Company*, 2009 WL 931704 (2009), reversed a trial court's finding that a Prior Damages Exclusion was ambiguous.

SUMMARY OF FACTS

Cal-State Steel Corporation ("Cal-State") was a subcontractor that installed structural steel and miscellaneous metal, including steel stairs and wrought iron railings, at the Rio Vista Project in 1996. Cal-State finished its work on the project in 1996. The entire Rio Vista Project was completed in December 1996.

The plaintiff in the underlying action claimed that a number of subcontractors, including Cal-State, provided defective workmanship at the Rio Vista Project. The plaintiff alleged that as a result of such defects, there was water intrusion. Specifically, the plaintiff alleged that "the handrails were not installed with the proper steel sleeve and they were not incorporated into a proper water-proofing system" and that, as a result, "beginning with the El Niño storms of 1997-1998, the Rio Vista Project suffered significant water damage due to faulty design and/or construction."

Golden Eagle Insurance Corporation ("Golden Eagle") issued a commercial general liability policy to Cal-State for the time period of June 27, 1996 to June 27, 1997 ("Golden Eagle Policy").

Gerling America Insurance Company ("Gerling") issued a commercial general liability policy to Cal-State for the time period of June 27, 1997 to June 27, 1998 ("Gerling Policy").

The Gerling Policy contained an exclusion in an endorsement titled "Prior Damages Exclusion" ("PDE Exclusion"), which stated, in pertinent part:

This insurance shall not apply to: 'property damage' ... arising out of any damage, defect, deficiency, inadequacy or dangerous condition which existed prior to the inception of the policy period ..., whether visible or invisible, detected or undetected, known or unknown, to any Insured before such inception date.... This exclusion shall be applicable to all damage(s), defect(s), deficiency(ies), inadequacy(ies) or dangerous condition(s) including, but not limited to, damage, defect, deficiency, inadequacy, or dangerous condition.... '[P]roperty damage' ... arising out of any damage, defect, deficiency, inadequacy or dangerous condition shall be deemed to have existed as of the earliest date by which any damage occurred, irrespective of whether the Insured was aware of the existence of any such damage, and irrespective of whether such damage may have been continuous or progressive or may have been due to repeated exposure to substantially the same harmful conditions or may have become progressively worse during

the period of this Policy.... We have no obligation to investigate or defend any liability, claim or suit to which this insurance does not apply.

Cal-State tendered the underlying action to both Golden Eagle and Gerling. Golden Eagle accepted the defense under a full reservation of rights. Gerling declined coverage based on the PDE Exclusion as "all of the alleged defects have existed since the original installation of the insured's work."

Ultimately, Golden Eagle's reinsurer, San Diego Insurance Company ("SDIC"), funded \$206,096.80 in defense costs and \$1,000,000 in indemnity to settle the underlying action on behalf of Cal-State. Golden Eagle thereafter instituted this action for contribution, subrogation and indemnity against Gerling for the amounts SDIC paid to defend and indemnify Cal-State.

COURT OF APPEAL RULING

The Court of Appeal determined that the trial court erred in denying Gerling's motion for summary judgment based upon the PDE Exclusion. The Court of Appeal held that there was no potential for coverage in the underlying action since the "alleged defect, deficiency, or inadequacy in Cal-State's work that caused the damage necessarily existed by the time the work on the Rio Vista Project was completed in 1996, prior to the inception of the Gerling Policy."

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Since the allegedly defective construction at issue in the underlying action existed prior to the inception of the Gerling Policy, the Court of Appeal held that the alleged property damage arising from that defect is excluded from coverage pursuant to the PDE Exclusion.

The Court of Appeal determined that it was irrelevant when the significant damage to the Rio Vista Project occurred because the endorsement did not require that both the damage and defect, deficiency, inadequacy, or dangerous condition exist prior to the policy's inception.

Since the alleged defect in the insured's work occurred before the inception of the Gerling Policy, the Court of Appeal held that the PDE Exclusion applied.

The Court of Appeal also noted that the PDE Exclusion, which essentially took away the \$1,000,000 in "Products-Completed Operations" coverage, did not make the policy illusory. In addition, the Court of Appeal noted that the reduced premium charged by Gerling of \$152,841.00 compared to Golden Eagle's premium of \$238,235.00 suggested that Cal-State purchased less insurance coverage from Gerling than from Golden Eagle.

COMMENTARY

Although this is an unpublished opinion, it is instructive on how California courts may interpret these types of "Montrose exclusions", especially in applying *Pepperell v. Scottsdale Ins. Co.*, 62 Cal.App.4th 1045 (1998). These types of exclusions, depending upon the language, may preclude coverage for damages during the policy period or continuous and progressive damage that flows into the policy period where the alleged defect, deficiency, inadequacy or dangerous condition giving rise to that damage existed prior to the inception of the policy period.

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