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California Insurance Coverage Law Alert

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Court of Appeal Terms Insurer's Act of "Hiding Behind An SIR" As "Gamesmanship"

Increasingly, insurers writing general liability policies for contractors and subcontractors are including provisions in their policies under which the payment of the Self Insured Retention ("SIR") by the named insured is a precondition to both the insurer's duty to defend and indemnify. When an insured tenders a construction defect claim asserting continuing and progressive property damage that is covered by general liability policies, the insurer without the "precondition" SIR will defend, but the carrier with the precondition SIR will decline defense, correctly predicting that the insured will not be motivated to contribute an SIR if it is receiving a free defense from the carrier without the precondition.

Just yesterday, California's Fourth Appellate District rejected the "precondition" defense to an insurance contribution lawsuit, observing that the non-participating carrier appeared "to have been hiding behind the SIR requirement in its policy, gambling that [the insured] would not satisfy it" because the defending and indemnifying insurer was providing a defense in the construction defect lawsuit. The Court "decline[d] to adopt a rule sanctioning such gamesmanship." *Axis Surplus Insurance Co. v. Glencoe Insurance, Ltd.* (4/11/2012) __ Cal. App. 4th __ (12 C.D.O.S. 3930).

The insured, Pacifica Pointe L.P., was sued in a construction defect lawsuit and tendered the claim to both Axis Surplus Insurance Company and Glencoe Insurance Ltd. Axis accepted defense under its commercial general liability policy. Glencoe issued a Wrap (owner controlled) insurance policy specifically insuring the construction project at issue. Glencoe did not accept Pacifica's tender, based on a \$250,000 SIR, under which Glencoe had no duty to investigate or defend until Pacifica satisfied the SIR. Instead, Glencoe reserved its rights and requested Pacifica provide evidence that it satisfied the SIR.

The Homeowners' Association ultimately made a \$1,000,000 settlement demand, which was scheduled to expire on December 17, 2008. Defense experts presented a Preliminary Cost of Repair estimate of \$1,400,000, not including acoustical claims or relocation costs. One day before the settlement demand was to expire, Glencoe stated that it was unable to evaluate the merits of the settlement demand before it expired, but had no objection to Pacifica contributing its SIR to a settlement funded by Axis. Glencoe did not agree that the settlement was for a covered loss. The case settled for \$1,000,000, with a written settlement agreement executed December 22, 2008. Thereafter, Axis paid \$750,000, and Pacific paid its \$250,000 SIR in settlement.

Axis sued Glencoe for reimbursement under case law entitling a settling carrier to obtain contribution from a non-defending carrier. Glencoe argued that because the SIR had not been paid *before* the settlement was reached, it was not in breach of the duty to defend and hence the settlement could not be enforced against it.

The Court of Appeal rejected Glencoe's argument, observing that Pacifica did not satisfy the SIR until it contributed to the settlement of the construction defect suit because Axis, a co-insurer, was defending Pacifica. Although Glencoe did not agree to contribute to the settlement, it specifically approved of Pacific's payment of the SIR as part of it. The court concluded:

To allow Glencoe to defeat an equitable contribution claim merely based on the timing of the payment of the SIR would award Glencoe for its inaction and work an injustice. Glencoe appears to have been hiding behind the SIR requirement in its policy, gambling that Pacifica would not satisfy it because Axis was providing Pacifica with a defense in the construction defect lawsuit. We decline to adopt a rule sanctioning such gamesmanship.

When the insured has tendered a claim to the non-participating insurer, the non-participating insurer's duty to defend is subject to the insured satisfying an SIR, and the insured satisfies the SIR as payment of a settlement of which the non-participating insurer was aware, the timing of the insured's payment of the SIR does not prevent the settling insurer from establishing the non-participating insurer's legal obligation to cover the underlying claim. To apply a more rigid rule in this matter would undermine the equity inherent in an equitable contribution action.

Axis provided two years of coverage to Pacifica. Glencoe was on the risk for three years. The Court of Appeal approved the trial court's allocation of 40% of the settlement to Axis, and 60% to Glencoe.

The Insurance Coverage Group at Burnham Brown is available to assist on "Precondition SIR" and other insurance coverage issues.

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