

London Law Update

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Oregon Court of Appeals Holds “No Duty to Defend” in Insurance Ruling

SYNOPSIS

On April 6, the Oregon Court of Appeals issued its decision in *State Farm Fire and Casualty Company v. American Family Mutual Insurance Company*. The case pertains to whether an insurer has a duty to defend where the complaint against the policyholder alleges defective construction of a building’s moisture protection system, but does not allege resultant water intrusion and damage. The court held that where such “special damages” are not specifically pled, there is no duty to defend.

THE FACTS

This coverage dispute arose from a construction defect suit against State Farm and American Family’s mutual policyholder for breach of contract, breach of implied warranties and negligence in the construction of a residence. The complaint alleged that the policyholder failed to apply the building’s Exterior Insulating Finishing System (“EIFS”) properly, and sought damages for the cost of repair — i.e., the cost of replacing the defective work with a proper EIFS. The complaint did not specifically allege that the defective EIFS allowed water to penetrate the building and cause damage to any other aspect of the structure, which is the primary danger when the EIFS is improperly installed.

DISCUSSION

The Court of Appeals noted that the duty to defend is determined by examining whether the allegations in the complaint could result in liability under the insurance policy — the so-called “eight-corners” rule. The duty to defend hinged on whether the underlying complaint alleged “property damage” under the policy despite not specifically alleging water damage to aspects of the structure other than the EIFS. (There was no dispute that damage to the EIFS itself was not covered.) Whether the complaint alleged “property damage” in turn depended upon whether any resulting water damage, which was not specifically alleged, would be classified as “general damages” or “special damages” under the pleading standards of Oregon law. “General damages” are those that “naturally and necessarily result from the particular type of injury

alleged,” and are not required to be pled with specificity. For example, replacement costs for the defective construction would be considered “general damages.” In contrast, “special damages” do *not* naturally and necessarily result from the injury alleged, and must be pled with particularity.

The Court of Appeals held that water intrusion and damage to the structure was not the necessary result of the defective EIFS. Water damage was therefore a “special damage” and had to be pled with specificity. Thus, in order for the plaintiff in the underlying case to recover for water damage against the policyholder, the plaintiff would have to amend the complaint before being allowed to introduce any evidence of water damage. While American Family might have a duty to defend under the hypothetical amended complaint, it had no duty to defend the complaint as drafted, because as drafted it would not permit evidence of, or recovery for, “property damage.”

The Court of Appeals’ decision in this case underscores the importance of examining the complaint closely when determining whether a duty to defend exists. A close examination of the complaint, together with a working knowledge of the relevant jurisdiction’s pleading laws, will result in more accurate coverage determinations.

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