The Colorado Court of Appeals rules that a statutory notice of claim triggers an insurer's duty to defend

Gene and Diane Melssen d/b/a Melssen Construction ("Melssen") built a custom home for the Holleys, during which period of time Melssen retained a CGL insurance coverage from Auto Owners Insurance Company. Soon after completion of the house, the Holleys noticed cracks in the drywall and, eventually, large cracks developed in the exterior stucco and basement slab. Thereafter, the Holleys contacted Melssen, the structural engineer, an attorney, and Auto-Owners, which assigned a claims adjuster to investigate the claim.

In April 2008, the Holleys sent Melssen a statutory notice of claim pursuant to C.R.S. § 13-20-803.5 ("NOC"). In this NOC, the Holleys claimed approximately $300,000 in damages related to design and construction defects. The Holleys also provided a list of claimed damages and estimated repairs, accompanied by two reports from the Holleys' consultant regarding the claimed design and construction defects. In June 2008, Melssen tendered the defense and indemnity of the claim to Auto-Owners. While Auto-Owners did not deny the claim at that time, it did not inspect the property or otherwise adjust the claim. Thereafter, in October 2008, Auto-Owners sent Melssen a letter denying coverage on the basis that the damage occurred outside of the applicable policy period.

Ultimately, Melssen settled the claims against it for $140,000. This settlement occurred prior to the Holleys' serving a complaint on Melssen and Melssen never provided the draft settlement agreement to Auto-Owners prior to execution. After the settlement, Melssen brought suit against Auto-Owners for breach of contract, bad faith breach of contract, and violations of C.R.S. §§ 10-3-1115 and 1116. After a three-day trial on the merits, the jury returned a verdict in favor of Melssen on all claims and awarded it damages. The trial court then ordered Auto-Owners to pay Melssen's costs and attorneys' fees.

In its appeal to the Colorado Court of Appeals, Auto-Owners argued that the trial court erred by submitting to the jury the question regarding whether the Holleys' NOC constituted a "suit" under the policy, which thereby triggered Auto-Owners' duty to defect Melssen. Auto-Owners' argument contended that the NOC process was neither a complaint (*i.e.*, suit) nor was it an alternative dispute resolution proceeding.

The Court of Appeals ruled, in its June 21, 2012 decision,[1] that the trial court indeed committed error in submitting this issue to the jury but that the error was harmless because the Holleys' NOC was, as a matter of law, a "suit" which triggered Auto-Owners' duty to defend. In so holding, the Court of Appeals ruled that the NOC constituted an alternative dispute resolution proceeding under the policy.

Auto-Owners also argued in the appeal that the NOC served as nothing more than a condition precedent to the Holleys filing suit against Melssen. Not persuaded, the Court of Appeals held that the NOC process constitutes an alternative dispute resolution proceeding, as well as serving as a condition precedent to the institution of a suit against a construction professional.

[1] Melssen v. Auto-Owners Insurance Company, 285 P.3d 328 (Colo. App. 2012).

Interestingly, during the appeal, Melssen also argued that C.R.S. § 13-20-808(7), enacted in 2010, applied retroactively to trigger Auto-Owners' duty to defend. That section states:

> An insurer's duty to defend a construction professional or other insured under liability insurance policy issued to a construction professional shall be triggered by a potentially covered liability described in:
>
> (1) A notice of claim made pursuant to section 13-20-803.5….

Because it had already determined that a NOC constitutes a "suit" under the insurance policy at issue, the Court of Appeals determined that it need not address the retroactive application of the 2010 amendments to the Construction Defect Action Reform Act. At least one panel of the Court of Appeals has previously held that C.R.S. § 13-20-808 should not be applied retroactively,[2] so the issue may be resolved, at least until the Colorado Supreme Court weighs in on the issue.

For more information regarding the Melssen case or construction litigation in Colorado, you can reach David M. McLain by telephone at (303) 987-9813 or by e-mail at mclain@hhmrlaw.com.

[2] TCD, Inc. v. American Family Mutual Insurance Company, 2012 WL 1231964 (Colo. App. April 12, 2012).