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# Montana Supreme Court: Earth Movement Exclusion Is Unambiguous

Overturning the trial court, the Montana high court found that the earth movement exclusion in a contractor's commercial general liability policy was unambiguous and precluded coverage for a structural damage claim caused by soil settlement.

**The Case**

Homeowners in Billings, Montana purchased homes built by a contractor insured by Employers Mutual Casualty Company (EMC). The homes developed cracks in the interior walls and foundation, eventually leading to misaligned doors and windows, separation of siding, larger cracks in the foundation and drywall, and foundation movement issues. The damage was caused by soil settlement under and around the homes.

The homeowners sued the contractor for negligent construction. They alleged that the contactor failed to install deep foundation systems in an area known to have sandy soils. The contractor denied any negligence and tendered the claim to EMC, who defended under a reservation of rights.

The contractor's CGL policy with EMC's had an exclusion added by endorsement for injury or damage from earth movement. The policy did not cover injury or damage "arising out of, caused by, resulting from, contributed to, aggravated by, or related to earthquake, landslide,

mudflow, subsidence, settling, slipping, falling away, shrinking, expansion, caving in, shifting, eroding, rising, tilting or any other movement of land, earth or mud."

EMC filed a declaratory judgment action seeking to get clear of the duty to defend. The homeowners filed their own declaratory judgment action seeking a declaration that EMC must indemnify the contractor for the homeowner's claims. The parties filed summary judgment motions on whether the earth movement exclusion applied.

The homeowners argued that the exclusion was ambiguous because it did not differentiate between natural and man-made earth movement causes.

The trial court interpreted the earth movement exclusion as applying only to earth movements caused by nature and not due to the insured's actions. Because the event here was alleged to be human caused, it held that the earth movement exclusion would not apply. It also found that the exclusion was ambiguous, and thus, awarded partial summary judgment to the homeowners. EMC appealed.

**The Montana Supreme Court's Decision**

The Montana high court disagreed and reversed the trial court's ruling.

Reading the policy as a whole, it found that the earth movement exclusion was not ambiguous. It looked first to the purpose of a CGL policy, which is to cover the insured for acts that result in injury or damage to others. A CGL policy, the court noted, differs substantially from first-party property coverage, "which draws on the relationship between perils that are either covered or excluded in the contract." Consistent with the purpose of a CGL policy, it provides no coverage for damages caused by purely natural events.

Turning to the specific language of the earth movement exclusion, the court found that it eliminates from coverage all property damage that the insured is legally obligated to pay related

to any movement of land, earth, or mud. The court said, "[t]here is no ambiguity here." That it does not differentiate between natural and human-caused earth movement does not make it ambiguous. Rather, it is by design; the exclusion broadly eliminates coverage for the insured's liability for damage related to any earth movements.

The court acknowledged that some earth movement listed in the exclusion would have a natural cause, but explained that such damage would be inflicted in combination with a human cause. The homeowners characterized their damage as "human-caused settling damage," but whether solely human-caused or in combination with natural causes, it is damage alleged to have been caused by the contractor that arises out of, results from, or is related to, "settling," a condition barred by the earth movement exclusion. The court found that if the insured incurs liability for damages related to any of the earth movements listed in the exclusion, regardless of cause, coverage is broadly excluded.

The case is *Loendorf v. Employers Mut. Cas. Co.* , No. DA 21-0449 (Mont. July 19, 2022).

## New Jersey Supreme Court: Judgment Creditor's Suit under Direct Action Statute Is Subject to Policy's Arbitration Clause

The New Jersey Supreme Court found that a condominium association may pursue claims for construction defects directly against the insurer of bankrupt contractors under New Jersey's Direct Action Statute. But because the condominium association stood in the shoes of the insured, it must pursue those claims through arbitration, as required by the insurance policy.

**The Case**

In a construction defect case, a condominium association obtained a default judgment against two contractors that it claimed were insolvent. Unable to recover on those default

judgments, it filed a declaratory judgment action directly against the contractors' professional liability insurer under New Jersey's Direct Action Statute (N.J.S.A. 17:28-2). The Direct Action Statute authorizes an injured claimant holding an unsatisfied judgment against an insolvent or bankrupt policyholder to file a direct action against an insurer "under the terms of the policy for the amount of the judgment in the action not exceeding the amount of the policy."

The trial court found that the Direct Action Statute did not apply because the condominium association did not prove the contractors were insolvent and granted the insurer's motion to compel arbitration. The Appellate Division reversed, finding that the statute did apply, and that the parties' dispute was not arbitrable. The dispute made its way to the New Jersey Supreme Court.

**The New Jersey Supreme Court's Decision**

The New Jersey Supreme Court agreed with the intermediate appellate court that the Direct Action Statute applied, but disagreed that the dispute was not arbitrable.

In finding that the Direct Action Statute applied, the court first rejected the insurer's argument that the statute applied only to claims arising from loss or damage to property caused by animals or motor vehicles. The court found that nothing in the text suggested that the legislature intended such a narrow reach. Instead, it found that the statute also applied to claims arising from loss or damage resulting from accidents or injuries suffered by an employee or other person for which the insured is liable.

The court next rejected the insurer's argument that the condominium association submitted inadequate proof of insolvency or bankruptcy. It considered a sheriff's affidavit stating that writs of execution were returned unsatisfied to be prima facie evidence that the contractors were insolvent.

It then turned to the final question: whether the dispute was arbitrable. The Appellate Division found that the condominium association was an incidental beneficiary of the contract and should not be burdened by the alternative dispute resolution agreement between the insurer and insured. The New Jersey Supreme Court disagreed.

The Direct Action Statute defines a judgment creditor's claim against the insolvent or bankrupt judgment debtor to be a claim "under the terms of the policy for the amount of the judgment in the action not exceeding the amount of the policy." The arbitration clause is one of the terms of the policy. Under the statute, the judgment creditor's rights are purely derivative of those the insured could have asserted against the insurer.

The New Jersey Supreme Court held the policy's arbitration clause applied and that the condominium association's claim against the insurer must be submitted to binding arbitration.

The case is *Crystal Point Condo. Ass'n v. Kinsale Ins. Co.,* No. 085606 (July 18, 2022).

## 11th Circuit Reverses Insurer's Bad Faith Win, Remands for New Trial

An insurer's victory in a bad faith case was short-lived after the Eleventh Circuit found that the district court improperly instructed the jury on Florida law. The district court informed the jury about bad faith resulting from a failure to settle, but didn't also instruct the jury that bad faith may exist when an insurer fails to advise an insured about settlement offers and likely litigation outcomes. Finding that the court's jury instructions prejudiced the plaintiff, the court overturned the judgment for the insurer and ordered a new trial.

The decision is particularly noteworthy because it arises in the context of a classic bad faith trap.

**The Case**

A motorcyclist was seriously injured in a collision with another vehicle. The driver was insured by Direct General Insurance. The policy had liability limits of $10,000 per person with a $20,000 cap per accident.

Upon learning of the accident, Direct General promptly investigated and sought to discover other insurance that may apply. The insured was unresponsive, and so was the motorcyclist's attorneys. After 11 attempts to contact the attorney, Direct General tendered the policy limits and sent a check to the attorney. The check was not cashed.

About a year later, the attorney contacted the insurer stating that he needed more information about the total coverage available. Direct General offered an affidavit, but this was rejected. Direct General continued to try to settle, but the attorney did not respond.

About eight months later, the attorney wrote the insurer stating that his client would sign a release if the insurer provided information about other insurance and if the settlement included uninsured motorist and medical payment claims. The attorney requested that the information be supplied in the next couple of weeks.

Direct General did not respond to the letter for more than two weeks but did try to finalize a settlement soon after. But the attorney claimed Direct General was too late and proceeded to trial, where his client was ultimately awarded $12 million. (The attorney later described this as a "time-limited settlement offer," but as the dissenting judge on the panel would explain, the letter never said it presented a time-limited settlement offer and simply requested information "in the next couple of weeks.")

As a judgment creditor, the motorcyclist then sued Direct General to recover the sums awarded by the jury. The motorcyclist alleged that Direct General breached its fiduciary duty to its

insureds and acted in bad faith. At trial, the motorcyclist put on an expert who opined that Direct General violated industry custom and practice by failing to settle the claim, and by failing to communicate with and advise its insureds. In response, Direct General argued that undisputed evidence showed that it attempted over 50 times to communicate with the attorney by letter and telephone to settle, and that it had fulfilled its obligation to keep its insured informed throughout the process.

The motorcyclist requested that the court charge the jury under both theories of liability – failure to settle and failure to advise. But the district court instead gave a standard jury instruction addressing only liability for failure to settle. The jury returned a verdict for Direct General and the motorcyclist appealed.

**The 11th Circuit's Decision**

The Eleventh Circuit reversed, finding that the district court's refusal to instruct on the failure to advise theory was an abuse of discretion and prejudiced the motorcyclist.

Direct General argued that the motorcyclist's proposed jury charge misstated the law by saying: "The focus of this bad faith case is not on the actions of [the motorcyclist] or his attorneys, but rather on the actions of Direct General and its obligations to act in good faith toward its insureds." Florida bad faith law requires consideration of the totality of the circumstances. Direct General argued that the proposed instruction was improper because it did not allow the jury to consider the responsiveness, or lack thereof, of the attorney as part of the totality of the circumstances. But the court was unpersuaded and found that the focus in a bad faith action is on the actions of the insurer and not the claimant. The court said there is a difference between *focusing* on a claimant's actions, which would be improper, and *factoring* a claimant's actions into the totality of the circumstances. The court ruled that the proposed instruction properly kept the

focus away from the actions of the motorcyclist's attorney while still allowing the jury to consider them.

The court also found that the proposed instruction dealt with an issue properly before the jury: bad faith for failure to advise. The court noted that this issue was presented throughout the case, and it was proper for the jury to consider both bad faith theories.

Because the trial court's instruction limited potential bad faith to only the failure to settle theory, the motorcyclist was prejudiced, and the trial court was found to have abused its discretion.

The Eleventh Circuit emphasized that it did not view the duty to advise as an independent theory of liability separate from the duty of good faith. But it said that bad faith liability may be triggered in several ways and the trial court's instruction described only one. The court also stressed that it was expressing no view on the merits of the motorcyclist's argument that Direct General acted in bad faith by failing to advise its insureds. "All we hold," the court stated, "is that when a party properly argues a theory of liability grounded in state law, a district court abuses its discretion if it causes prejudice by failing to instruct the jury on that theory."

The Eleventh Circuit, however, found that the trial court did not abuse its discretion when it instructed the jury to consider the totality of the circumstances and not simply that period after the attorney sent the so-called "time-limited" demand letter.

One judge, in a strong dissenting opinion, found no abuse of discretion because the proposed instruction misleadingly stated Florida law on bad faith failure to settle and that the district court need not tinker with the flawed proposed instruction until it was legally acceptable. Nor was the judge persuaded that the motorcyclist was prejudicially harmed because the jury

understood that Direct General's communications with its insured were relevant to its duty of good faith.

This decision illustrates the need for an insurer to remain vigilant throughout the claims handling process. Here, the insurer attempted for years to pay its policy limit and resolve the claim. But because those limits were insufficient when compared to the claimant's injuries, the claimant's attorney tried to find a way to make the insurer responsible beyond its policy limits. The attorney apparently never really intended to settle and set a trap that the Eleventh Circuit majority backhandedly endorsed. Whether the insurer will ultimately be found to have acted in bad faith remains to be seen. But the fact that the insurer must go through a second trial despite trying over and over to resolve the claim – the dissenting judge describes these efforts in detail – is troubling for insurers.

The case is *Brink v. Direct Gen. Ins. Co.,* 38 F. 4th 917 (11th Cir. 2022).

## Illinois Appellate Court: Intentional Acts Exclusion Applies to Consumer Fraud Claim

An Illinois appellate court applied an intentional acts exclusion to a claim under an Illinois consumer fraud statute despite limiting the exclusion to the insured's intentional misconduct.

**The Case**

Julio Salas and the insured, Don McCue Chevrolet, Inc., entered into a retail installment contract for Salas to purchase a new 2020 Chevrolet truck from the insured. Under the sales contract, Salas provided $5,000 cash and his 2018 Chevrolet vehicle as a down payment. Salas and the dealer agreed that the sales contract would be assigned to a finance company or bank. If the dealer could not assign the contract, the transaction would not be completed, Salas would return

the new truck, and the dealer would return to Salas the $5,000 and the 2018 vehicle. The dealer could not obtain financing for the purchase. Salas returned the new truck, but the insured refused to return the $5,000 or the 2018 vehicle.

Salas brought a single-count complaint against the dealer in Illinois state court. The complaint alleged a violation of Illinois's Consumer Fraud and Deceptive Business Practices Act and that the dealer's "deception" damaged Salas.

The dealer submitted a claim for insurance coverage. Its insurer, Owners Insurance Company, denied coverage, citing an intentional acts exclusion. That provision excluded coverage for any suit resulting from "[a]ctual or alleged criminal, malicious or intentional acts" committed by the insured.

The insurer filed a declaratory judgment action. The issue seemed pretty straightforward. The deal for the new truck fell through. The buyer returned the truck as requested, but the dealer refused to return the buyer's deposit or trade-in. How is that anything but intentional misconduct?

Yet the insurer lost before the trial court. The court granted summary judgment to the dealer.

**The Illinois Appellate Court's Decision**

The appellate court reversed. The court first looked to rules of construction to determine the scope of the exclusion. Under the *noscitur a sociis* doctrine, the grouping of the words "intentional," "criminal," and "malicious" in the intentional acts exclusion meant they should be interpreted with similar meanings. The court found that the word "intentional" referred to intentional misconduct, not any intentional act.

Still, the court held the allegations of the complaint fell within the exclusion. The complaint generally referenced the insured's "conduct" without modifiers, such as "intentional" or "willful." But when read as a whole, the complaint centered on the insured's refusal to return the money or vehicle, and that reflected intentional conduct. The court noted that under ordinary dictionary definitions, the word "refuse" implies intentional or willful conduct. And inclusion of the words "fraudulent" and "deception" in the complaint further expressed the intentional nature of the misconduct.

For these reasons, the court held the intentional acts exclusion applied, reversed the judgment of the trial court, and remanded the case to the trial court with directions to enter summary judgment for the insurer.

The case is *Owners Ins. Co. v. Don McCue Chevrolet, Inc.*, No. 2-21-0634 (Ill. App. Ct. 2d Dist. July 7, 2022).

## Tenth Circuit: Intentional Loss Exclusion Bars Fire Damage Claim

The Tenth Circuit, siding with an insurer, applied an intentional loss exclusion to a fire set by an eighteen-year-old to her father's bedspread.

**The Case**

The Taylors owned a home in El Dorado, Kansas, where they lived with their 18-year-old daughter, Zoe. In October 2017, the Taylors bought a homeowner's insurance policy from LM Insurance Corporation. The policy covered fire damage but included an "Intentional Loss" exclusion that excluded "any loss arising out of any act committed: (1) [b]y or at the direction of an 'insured'; and (2) [w]ith the intent to cause a loss." The exclusion applied whether the loss was

"caused directly or indirectly," and "regardless of any other cause or event contributing concurrently or in any sequence."

The Taylors' 18-year-old daughter was home alone and used a lighter to ignite her father's side of her parents' bedspread. The fire spread beyond the bed and damaged the house.

The Taylors submitted a claim to LM. LM denied the claim under the Intentional Loss exclusion, as the daughter was an "insured" under the policy.

The Taylors then sued LM for coverage. LM prevailed before the trial court and the Taylors appealed.

**The Decision**

The Tenth Circuit, applying Kansas law, affirmed the district court's ruling. The court ruled that no reasonable juror could conclude that the daughter was unaware that lighting a bedspread would cause it to burn. The court held that the daughter's history of seizures did not alter the result because Kansas law presumes sanity, and the Taylors offered no evidence to rebut that presumption. Indeed, the daughter admitted to burning the bedspread to upset her father and there was no evidence that she was experiencing a seizure at the time of the incident.

The Taylors argued that the Intentional Loss exclusion was ambiguous because it did not specify that it only applied to "covered property." The court rejected this argument. If the property wasn't already covered, you wouldn't even need to reach the exclusion.

The court affirmed the judgment of the district court.

The case is *Taylor v. LM Ins. Corp.*, No. 20-3166 (10th Cir. July 21, 2022). Note: This decision is not binding precedent, but it may be cited for persuasive value under Fed. R. App. P. 32.1 and 10th Cir. R. 32.1.

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