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The Eight Corners Rule: Uncertainty On Duty To Defend


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Law360, New York (April 04, 2014, 5:44 PM ET) -- When determining whether there is a duty to defend allegations of property damage under a commercial general liability policy, it can matter a good deal whether a court looks only to the policy and underlying complaint or to other documents as well. Two recent federal cases from adjoining southern states demonstrate this effect.

In a Mississippi case, the CGL insurer of a construction company filed a declaratory judgment action, disputing coverage for an underlying suit. Accident Ins. Co. v. Byrd (S.D. Miss. Aug. 30, 2013), adopted by 2013 U.S. Dist. LEXIS 141523 (S.D. Miss. Sept. 30, 2013). In the underlying suit, a homeowner alleged that the construction company breached its contract by failing to properly find and repair a leak in the residence as well as repeatedly misrepresenting that it had repaired the leak.

The court noted first that in the context of CGL cases, Mississippi courts follow the “eight corners” rule, in which the court compares the allegations of the complaint to the policy language. Because the insurer alleged that there was no occurrence, the court looked only to the allegations in the underlying complaint and the policy to determine whether there was an occurrence under Mississippi law. The Mississippi Supreme Court has held that the act is not an "accident," and thus not an "occurrence" if: (1) the act is committed consciously and deliberately without the unexpected intervention of any third force; and (2) the likely — and actual — effect of the act was well within the actor’s foresight and anticipation.

The court then turned to the allegations in the complaint and held that they did not suggest that the construction company inadvertently failed to do anything, but rather that it purposely breached its duty and failed to repair the leak. Even if the company did not intend to harm the homeowners, it intentionally set in motion the injuries by providing an inaccurate report of the leak repairs. There was no unexpected intervention of a third force and the company could anticipate that the report would be relied upon. A negligent misrepresentation claim requires knowledge that the representation is false, and breach of contract actions do not result from accidental losses. The fact that the property owner claimed punitive damages was another indication that the actions alleged were intentional.

Because there was no "accident" alleged in the underlying complaint, the federal magistrate judge recommended that the insurer’s motion for summary judgment be granted. The district court adopted that recommendation.

In an Alabama case, two consecutive liability policies were at issue. Cincinnati Ins. Co. v. Amerisure Ins. Co., 2012 U.S. Dist. LEXIS 129953, (S.D. Ala. Sept. 12, 2012). The builder corrected problems with balconies on a residential building in 2004 without making a claim. Construction was completed, but in 2007 additional problems with the balconies developed. The property owner sued, seeking damages caused by "the improper substitution of materials, improper waterproofing details and design, the improper execution of waterproofing details and/or the improper use and installation of materials."

One insurer argued, inter alia, that it did not have a duty to defend or indemnify because there was no occurrence. The policy defined occurrence as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The court summarized a recent Alabama Supreme Court case, Town & Country Property v. Amerisure Insurance, and noted that "the rule in Alabama is that there is an 'occurrence' when faulty work results in damage to nondefective parts of a structure or property, but that there is no occurrence insofar as the insured is held liable for repairing or replacing the faulty work itself."

Under Alabama law, "the insurer owes no duty to defend only if neither does the complaint against the insured allege a covered accident or occurrence nor does the evidence in the litigation between insurer an insured prove a covered accident or occurrence." The court was to look to "both the allegations of the underlying complaint and additional record facts outside the complaint to determine whether a covered occurrence has been alleged or proved." The court noted that the property owner's complaint sought recovery for the cost of repairing faulty work to the balconies themselves and there was no "occurrence" as to those damages.

The court noted, however, that underlying complaint also referred to "replacement of surrounding components," and reviewed additional documents from the underlying litigation. This included a schedule of damages that included replacement of drywall and stucco and photographs supplied by the property owner during the litigation that showed damage to nondefective areas. Because there was "no evidence and no reason to believe" that the original installation of the drywall or stucco were defective, this damage constituted property damage resulting from an "occurrence." The insurer therefore had a duty to defend.

These cases indicate that an insurer, when evaluating a duty to defend, should consider whether state law at issue requires only a comparison of the underlying complaint to the policy, or takes into consideration other "record facts" as well.

Jurisdictions have varying rules regarding what an insurance company needs to do in the face of uncertain coverage when reviewing a complaint. In Georgia, the court of appeals has stated that an insurer should file a declaratory judgment action where coverage is uncertain. Landmark Am. Ins. Co. v. Khan, 307 Ga. App. 609, 705 S.E.2d 707 (2011). In Khan, the insurer of a nightclub declined to provide a defense to the club in a shooting case. The court held that the insurer should not have denied a defense outright; rather, where there is any uncertainty of liability coverage, the "reasonable option" is to "defend[] the case under a reservation of rights, request[] a stay of the underlying case, and file[] a declaratory action to determine its obligation to provide a defense."

Although some states may consider this option extreme, in states that follow this approach, insurers should consider a declaratory judgment action if coverage is unclear.

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