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Duty to Defend Re-Emphasized: Insurers Need To Be Certain There Is No Duty To Indemnify Before Denying The Duty To Defend

By Ashley S. Zaleski

In *Hastings Mut Ins Co v Mosher Dolan Cataldo & Kelly, Inc and Feinbloom,* _ Mich _, rel'd 12/10/14 (No. 149201), the Supreme Court reversed the January 23, 2014 judgment of the Court of Appeals stating that it erred in holding that Hastings did *not* have a duty to defend Mosher Dolan ("MDCK") in the underlying arbitration action. The claimants in the underlying arbitration case alleged water damage to personal property that was not excluded from coverage by any of the exclusions in Hastings policy. Therefore, although the Fungi Exclusion excluded coverage for some of the claims asserted in the arbitration case, Hastings had a duty to defend MDCK, and because Hastings had a duty to defend, it is not entitled to restitution.

Hastings issued commercial general liability ("CGL") policies to MDCK. The Feinblooms hired MDCK as the general contractor to construct a custom-built residence. The Feinblooms' children suffered from a respiratory illness, so the family wanted an environmentally safe residence with minimal exposure to mold, bacteria and toxins. The Feinblooms hired consultants to work with MDCK to ensure that the construction complied with sound environmental standards. Less than one year after moving into their new home, the Feinblooms initiated arbitration proceedings against MDCK alleging that their home was dangerously contaminated with mold, bacteria, and toxins, and that MDCK negligently allowed structural timber to become wet and moldy during construction, and negligently installed a grinder pump that backed up and spread contaminants throughout the house. MDCK requested that Hastings defend and indemnify it in the arbitration proceeding pursuant to its CGL policy.

Hastings questioned whether the Feinblooms' defective construction claims constituted an "occurrence" for which coverage was available, or whether the claims were subject to a mold exclusion in the policy. The Feinblooms also sought recovery of the costs of all of the furniture and furnishings and other contents of the residence that were contaminated by mold spores and toxins.

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The Supreme Court's reversal of the Court of Appeals January 23, 2014 judgment in *Hastings* clarifies just how expansive an insurance company's duty to defend is. If it is a close call, the insurer needs to provide a defense and then, after there has been some discovery and perhaps the claims have been narrowed, then the insurer can take a definitive position on the duty to indemnify. Insurers need to be aware that the duty to defend is broader than the duty to indemnify, and that the duty is imposed even in regards to "groundless, false or fraudulent" claims, "so long as the allegations against the insured even arguably come within the policy coverage." Therefore, insurers should exercise caution and need to be certain there is no duty to indemnify on any claim before they deny their duty to defend.

According to the lower court, Hastings advised MDCK that it would cease covering their defense costs, as the policy did not provide coverage for the defense of Feinblooms' ongoing claims because those claims did not arise from an "occurrence" as defined by the policy. According to Hastings, damage to MDCK's own work product (i.e., the constructed residence) was not an occurrence. Hastings averred that the arbitrator's decision not to award the Feinblooms damages for destruction of their personal property (furniture and other household contents) meant that the Feinblooms' surviving claims were not subject to liability coverage under the CGL policies. Hastings then moved for summary disposition under MCR 2.116(C)(10). *Id.* at *5. Hastings argued that it had no duty to either defend or indemnify *any* of the Feinblooms' claims because each claim came within either a fungi exclusion endorsement in the 2003-2004 policy, or policy exclusions (m) (damage to impaired property or property not physically injured) or (n) (recall of products, work, or impaired property). Hastings relied on its own policy language that there is no duty to defend if the insurance policy does not apply. The trial court disagreed and denied Hastings's summary disposition motion. The case proceeded to trial and a jury returned a verdict in MDCK's favor.

The Court of Appeals determined that the trial court originally erred in denying summary disposition for Hastings. The Court of Appeals explained that "the CGL policies provide that Hastings's duty to defend is coterminous with its duty to indemnify, and it had no duty to indemnify MDCK for any damages to the Feinblooms' personal property because the Feinblooms' claims were excluded by the fungi damage endorsement and exclusion (n)." The Court of Appeals held that Hastings was entitled to judgment as a matter of law on the issue of the duty to defend because the Feinblooms' claims for fungi damage were excluded from coverage, and Hastings had a right to restitution of benefits erroneously paid to MDCK.

The Supreme Court reversed, holding that an insurer has a duty to defend, despite theories of liability asserted against the insured that are *not* covered under the policy, if there are "any" theories of recovery that fall within the policy.

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