"Damned If You Do, Damned If You Don't" - Pitfalls to Watch Out for With Insurance Coverage and Claims That Contractors Will Make Against an Insurance Policy

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The United States District Court for the Western District of Michigan recently granted judgment in favor of our client against its insurer for a claim involving defective gravel. (Case No.: 1:07-cv-00112-jtn, U.S. District Court Western District of Michigan, dated April 3, 2009.) The client was under extreme pressure to rebuild the road, which was rendered unpermittable by a county because the asphalt "pimpled" and cracked from a particulate in the gravel sub base, known as ettringite. The ettringite, under proper soil and clay conditions, expanded and caused the damage to the asphalt.

After learning of the problem, the client put its insurer on notice of the claim. The insurer responded with a reservation of rights letter. The owner, who was preparing to open a new housing subdivision accessible by the road, was anxious to get the road repaired. After several meetings between the owner and the road contractors involved in constructing the roadway, an engineering firm was hired to determine how the problem developed. As spring was fast approaching, the owner was desperate to have the project open so it could sell the homes it was constructing and the lots it had developed. The owner threatened to sue the client for the damaged road and lost profits from some sales if the road was not repaired during the spring.

The client also began discussions with its insurer about how to pay for the road replacement. The insurer hired its own engineering firm to inspect the project. Its engineering firm advised the insurer that there was a potential for environmental contamination and that in its opinion, the road had to be replaced. The insurer then agreed to pay for at least part of the client's claim, stating that the policy covered the cost to replace the asphalt only. The client then, with the help of other contractors, replaced the damaged roadways at a cost of approximately of $230,000.

When the client advised the insurer of the cost, the insurer refused to pay any amount of the money, including the cost for the new asphalt. The insurer claimed that it was not obligated to pay because the client made a voluntary payment (i.e., replaced the defective road) without approval from the insurance carrier.

The insurance policy language the insurer relied upon states:

1. Duties In The Event of Occurrence, Offense, Claim or Suit
    a. No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation or incur any expense, other than for first aid, without our consent.

Although the insurer's engineer stated in writing that there was a potential environmental problem and that replacing the road was necessary, and although the insurer had agreed to pay at least

The client then filed suit against the carrier. After extensive discovery and a hearing, Judge Janet Neff, U.S. District Court Judge for the Western District of Michigan, entered a judgment in favor of the client for $100,000, minus the $25,000 deductible on the policy. The Judge ruled that the insurer was estopped from denying that it owed coverage for at least the cost and expense of replacing the damaged asphalt, which the insurer had previously agreed to pay for under the policy.

The Court stated that although the insurance policy must be enforced according to its plain and unambiguous terms, the doctrine of estoppel prevented the insurer from denying coverage at least in part. The court also concluded, however, that the insurance carrier set forth valid defenses to coverage on the grounds that the client failed to get the insurer's approval to perform the additional work before it performed the work, and therefore the insurer was not obligated to pay anything more than what it previously agreed to pay.

The lesson from this decision is that contractors should obtain a written statement from their insurer before taking remedial or corrective action. Often, corrective action has to be taken quickly to avoid additional damages. The owner threatened to sue the client for lost profits arising from its inability to sell lots and homes in the subdivision because the road was not approved. If the client was required to wait for the insurance carrier to make a decision before taking corrective action, it would have exposed itself to substantial damages and losses exceeding the costs to replace the road, as well as litigation costs. It is likely that the insurer would not have resolved the claim with the owner or the client quickly enough to avoid additional damages. The client faced the classic problem of being "damned if you do, damned if you don't." It chose to take the corrective action promptly to avoid litigation and other possible damages arising from environmental problems and lost sales, but as a result, its insurer denied coverage. It took a court order to force coverage, at least in part, to recover some of the expenses that the client incurred in replacing the roadway.

In summary, before taking quick corrective action to repair defective materials that may be covered by insurance, it is recommended that your insurer be put on notice and that you get the insurer to agree to make payment. Otherwise, you risk losing insurance coverage.