

Sixth Circuit Affirms Liability Insurer's Broad Duty to Defend and Binds Insurer to Judgment Against Landlord

In a victory for policyholders, the Sixth Circuit affirmed that a landlord's insurer owed a duty to defend the landlord in a bodily injury claim arising out of a fire that killed three and injured one. The Court held that the insurer breached its duty to defend and was bound to the insured's \$3 million consented judgment.

Transition Investments LLC, an owner of three properties in the Detroit area, purchased a general liability insurance policy with Hamilton Specialty Insurance Company to insure its properties. At one of the properties, a faulty stove started a fire, destroying the building, injuring one person and killing three others. The estates of the deceased and the injured party sued Transition in Michigan state court. In their complaint, the plaintiffs contended that Transition failed to provide a habitable premise and neglected to maintain the property's stove, which allegedly caused the fire. The plaintiffs argued that Transition's negligent maintenance of the property led to the fire and the resulting injuries. Transition subsequently tendered the claim to Hamilton. Hamilton claimed that the insurance policy did not cover the fire's damages and refused to participate in the state court litigation. Ultimately, Transitions entered into a consent judgment with the plaintiffs for \$3 million.

After the plaintiffs sought a writ of garnishment to recover from Hamilton, Hamilton sought a declaratory judgment in the Eastern District of Michigan to confirm that it was not liable for the consent judgment. The plaintiffs and Transition responded by seeking a declaration that Hamilton breached its duty to defend and was bound to the consent judgment.

The central question for the court was whether Hamilton breached its duty to defend Transition by not participating in the state court litigation or whether Hamilton never owed a duty to defend Transition in the first place. In coming to its decision, the Court underwent a textbook coverage analysis: (1) was coverage triggered by the complaint? (2) if coverage was triggered, did any exclusionary provisions of the policy apply? and (3) had Transition breached the policy contract by entering into the consent judgment?

As to the first question, the court quickly concluded that the plaintiff's complaint fit squarely within Transition's insurance policy. Because the claims clearly alleged that the injuries were caused by Transition's negligence, the court could not understand how "Hamilton divined that it had no duty to defend Transition in the state court action." Hamilton Specialty Ins. Co. v. Transition Inv., LLC, No. 19-1935, 2020 WL 3397743, at *4 (6th Cir. June 19, 2020).

The court then examined the two exclusionary provisions Hamilton raised to support its no coverage position. Hamilton first argued that the policy excused coverage because Transition's damages were incurred "by reason of assumption of liability in a contract or agreement." Pursuant to well-settled Michigan law, the "assumption of liability" exclusion applies when the insured assumes the legal obligation or responsibilities of another, such as in "hold harmless or indemnification agreements." Thus, Hamilton would need to show

that Transition's liability arose out of third-party liability for the provision to be applicable. Again, the court quickly dismissed this argument by finding that the plaintiffs' complaint unambiguously alleged that it was Transition's negligence, and not some third-party negligence, that caused the fire.

Next, the court analyzed whether the policy provision excluding damages "arising out of" or "resulting from" violations of various statutes addressing habitability, including civil codes, health and safety codes, housing laws, and administrative regulations prohibited coverage. The court opened its analysis with the conclusion that a statutory violation alone does not trigger the exclusionary clause under the policy's plain language. The exclusion's applicability requires a causal nexus between the complained condition and the liability allegation of the complaint. Nevertheless, the court resolved this nexus question by returning to the legal standard: Is there an arguable interpretation that permits coverage? If Transition could put forth an arguable interpretation that something other than a violation caused the damages, Hamilton could not rely on Transition's statutory violation to avoid its duty to defend. Because the state court complaint did not assert that any regulations or violations caused the injuries, Hamilton could not show that the policy's exclusionary clause unarguably prohibited coverage.

Finally, Hamilton argued that irrespective of the exclusionary clauses, there was no duty to defend because Transition violated the policy provision prohibiting Transition from entering into agreements that could bind Hamilton. However, the court found that the record was clear that Transition only entered into the consented judgment after Hamilton declined to defend it in the state court litigation. Thus, the court held that Hamilton could not rely on Transition's settlement to justify not defending its insured. Under Michigan law, "[i]f an insurer wrongfully declines to defend, the insurer is liable for the costs of defense as well as any reasonable, good-faith settlement paid by the insured." *N. Bank v. Cincinnati Ins. Co.*, 125 F.3d 983, 986 (6th Cir. 1997). Moreover, Hamilton did not offer any evidence to refute that the consented judgment was reasonable; thus, Hamilton was bound by the consented judgment.

This case is a win for policyholders and should be a signal to Insurers that it is a dangerous practice under Michigan law to flatly refuse to participate in litigation, even when it may feel confident that there is no coverage. Michigan law makes it difficult for insurers to deny coverage absent a clear-cut language precluding coverage. The Insurer must look beyond the complaint's allegations and must consider groundless, false, or fraudulent allegations when assessing whether there is a duty to defend. In this case, Hamilton clearly could have agreed to defend under a reservation of rights without giving up any rights up the policy. The duty to defend is broad under Michigan law. Policyholders can use this case as strong support that a duty to defend is owed so long as an arguable interpretation of policy language permits coverage.

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