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NEWSLETTER

Demand for Repairs or Recoupment of Repair Costs Not a "Claim"; Prior Knowledge and Application Exclusions Bar Coverage

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Applying Pennsylvania law, the United States District Court for the Western District of Pennsylvania has held that the state's demand that the insured engineering company perform repairs or pay the state the cost of the repairs was not a "claim" under the applicable architects and engineers professional liability policy because the demand did not allege that the engineering company acted negligently. *McMillan Engineering, Inc. v. Travelers Indem. Co.*, 2010 WL 3896418 (W.D. Pa. Sept. 30, 2010).

The insured provided engineering services to a county agency that was conducting an engineering project on land adjacent to a state highway. During the project, earth unexpectedly subsided. The state transportation agency met with the county agency and the engineering company to inform them that the construction work had jeopardized the lateral support of the state highway, and to inform them that the state believed they should pay for necessary repair work to correct the problem. The state agency followed up by sending a letter formally putting the county agency and the engineering company on notice that the state intended to exercise its rights under a state statute that makes adjacent landowners strictly liable for failure to provide lateral support to state highways. The letter did not allege that any entity committed any negligent act. The engineering company's investigation suggested that a utility company's poor construction work on its easement had caused the problem.

Two days before the expiration of the engineering company's professional liability policy, the utility company sued the engineering company, alleging that its negligence caused harm to the utility's underground lines. The engineering company, in the process of applying for insurance with a different carrier, did not disclose any information about the matter, despite revising in other ways its application after receiving service of the complaint. After the new policy incepted, the state agency sent another letter demanding repayment of the costs of repair from the county, which forwarded the letter to the engineering company and demanded that it pay. After the engineering company tendered the matter to the insurers, they both denied coverage.

The district court granted summary judgment to the insurers. The court held that both policies' definitions of "claim" required an allegation of negligence—both policies included the phrase "negligent act, negligent error or omissions" in their "claim" definition. The court further held that the state agency's demand letters did not

constitute a claim under these definitions because they did not allege negligence. Rather, the letters relied on a statute that imposed strict liability without requiring a showing of negligence. Likewise, the county agency's request that the engineering company pay the bill for the state was not grounded on negligence, or indeed on any tort, but on contract by operation of Pennsylvania law.

The court then held that the engineering company did not timely report the matter under the earlier policy's notice of potential claims provision, which had expired before the engineering company reported any potential claim.

The court further held that the engineering company's knowledge of the matter before the latter policy incepted foreclosed any possibility of coverage. The court quoted the application language, which asked if the applicant was "aware of any facts, circumstances, incidents, situations, or accidents (including but not limited to . . . construction dispute . . .) that may give rise to a claim, whether valid or not, which might directly or indirectly involve [you]." The court noted that the engineering company did not disclose the facts and circumstances of which it was aware on its application. The court further quoted the application's statement that "it is understood and agreed that if any such claims exist, or any such facts or circumstances exist which could give rise to a claim, then those claims and any other claim arising from such facts or circumstances are excluded from the proposed insurance." The court noted that the application provisions, in contrast to the definition of "claim," did not require an allegation of negligence, but merely required that a reasonable person recognize that a situation existed in which a third party reasonably could be expected to allege that the engineering company was negligent. The court also observed that the application formed a part of the parties' contract. Further, the court quoted a policy exclusion that applied if the insured was "aware or reasonably should have been aware" of the claim or of facts that gave rise or could reasonably be expected to give rise to the claim before the policy's inception. The court held that, in light of the insured's knowledge at the time of the policy's inception, both the application and the policy exclusions barred coverage. The court rejected the engineering company's argument that it had not yet received the policy when it finalized its application, noting that the application language itself was clear on the consequences of nondisclosure.