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ALERT

Setoff Is Not "Damages" or Insurable Loss

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The Appellate Division of the New York Supreme Court has held that, under New York law, a setoff for defective work by an insured construction management company was not "damages" or insurable loss under an environmental liability policy. *O'Brien & Gere Technical Services, Inc. v. New York Liquidation Bureau (Reliance Insurance Company in Liquidation)*, 2011 WL 589632 (N.Y. App. Div. Feb. 22, 2011). The court also determined that the management company was not covered under the policy's professional negligence provision because the profession at issue was that of the management company's engineering affiliate, a separate legal entity.

The insured management company had been awarded $5 million in an action to recover under a construction contract, but the court deducted $1.3 million from the award as a setoff for defective work in the design of the building. The management company submitted a claim as an additional named insured on an environmental liability policy issued to the management company's engineering affiliate, a separate legal entity employed as a subcontractor on the project. The management company contended that the setoff was "damages."

The appellate court determined that the setoff did not constitute "damages," defined under the policy as "a monetary judgment, award or settlement of compensatory damages. DAMAGES does not include . . . equitable relief or the return of fees or charges for services rendered or expenses incurred by the INSURED for redesign, changes, additions or remedies necessitated by a CLAIM." The court determined that this definition "unequivocally excluded" amounts attributed to defective and incomplete work. The court noted further that "it is well established that such a setoff is uninsurable as a matter of law." According to the court, "New York law is clear that the

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refund of monies to which a party is not entitled is not an insurable loss."

The court also rejected the management company's argument that the setoff was covered under the policy's professional liability provision, which applied to acts, errors and omissions "arising out of the conduct of the INSURED's profession." The court determined that, if there were professional negligence, it was attributable to the profession of the management company's engineering affiliate. Because any acts, errors and omissions did not arise out of the management company's profession, the professional negligence provision was not implicated by the management company's claim under the policy. The court noted, however, that the engineering affiliate, the named insured, might have a claim under the policy.