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Case Study

Determining the Duty to Defend in a Construction Defect Case

— by Jeffrey D. Eberhard

Claims Pointer: In a defective stucco case, the Oregon Court of Appeals holds for the first time that in evaluating an insurer's duty to defend, a court may consider facts outside the complaint to determine whether a party is an insured under the policy.

When coverage is contested, the Oregon courts typically employ the “four-corners” rule in evaluating whether an insurer has a duty to defend an insured in an action. That is, a court will look only within the “four-corners” of each of two documents – the complaint and the insurance policy – and not beyond, in making this determination. In the recent case Fred Shearer & Sons, Inc. v. Gemini Insurance Co., 2010 WL 3768022 (September 29, 2010), the Oregon Court of Appeals held for the first time that in evaluating an insurer's duty to defend, a court may consider facts outside the complaint to establish whether a party is an insured under the policy.

Defendant Gemini Insurance Company (“Gemini”) insured TransMineral USA (“TransMineral”), a distributor of a stucco product. Plaintiff Fred Shearer & Sons, Inc. (“Shearer”) was hired by a contractor to apply the TransMineral stucco to the exterior of a home. The stucco allegedly cracked, causing leaking and mold, and the homeowners sued the contractor who, in turn, sued Shearer and TransMineral. Shearer tendered the defense of the lawsuit to Gemini – TransMineral's insurer – because the Gemini policy extended coverage to any person or organization that distributed or sold TransMineral's products in the regular course of its business. Shearer was a vendor of TransMineral's stucco product, operating under an exclusive agreement with TransMineral.

Gemini refused to defend Shearer, and Shearer filed an action to establish that Gemini had a duty to defend it in the homeowners' action. The trial court granted summary judgment in Shearer's favor, and Gemini appealed.

Before the Court of Appeals, Gemini argued that it was impossible to tell from the policy or the pleadings in the underlying action that Shearer sold or distributed the stucco product in the ordinary course of its business. Therefore Gemini asserted that, based upon Oregon's longstanding “four-corners” rule, the policy and the facts alleged in the pleadings were insufficient to show that Shearer was a covered insured and the complaint should have been dismissed.

The Court held that while applying the “four-corners” rule makes sense in determining whether alleged *conduct* falls within the scope of coverage, there is no logical justification for limiting to the four-corners of the complaint a determination of a party's *status* as an insured. The Court reasoned that pleadings generally contain only facts relevant to the merits of a case, and, since facts relevant to an insured's relationship with its insurer may not be relevant to the merits of the case, such facts may not be contained in a pleading. Therefore, the Court held for the first time that the “four-corners” rule in duty-to-defend cases does not apply when the issue is whether a party is an insured under a policy, and, under those circumstances, the court may consider facts not alleged in the complaint. Thus, looking outside the four-corners of the complaint and the policy, the Court affirmed the trial court's holding and held that Gemini had a duty to defend Shearer.

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