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Legal Alert

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New Appeals Court Decision Eliminates Insurance Coverage for Construction Defects

Anna H. Oshiro

Mark M. Murakami

In May of this year, the Intermediate Court of Appeals issued an appellate decision that is wreaking havoc in the construction industry. The decision is called Group Builders Inc. v. Admiral Insurance Company, and in it, the court held that construction defects are not "occurrences" under commercial general liability ("CGL") insurance policies. In plain language, the court held there is no CGL insurance coverage for construction defect claims.

The repercussions of this decision were immediate and dramatic. During the construction boom over the past five years, Hawaii contractors constructed or worked on hundreds of commercial and residential developments, commercial buildings, condominiums, and public projects. Projects that were in litigation and headed towards mediation, have seen settlement discussions derailed by insurers who have walked away from the bargaining table. The insurance companies withdrawal is based on their argument that the Group Builders case has settled the question of whether they have any responsibility to defend or pay claims for construction defects. Already, at least 5 complaints have been filed in the federal and state courts by insurers asking the courts to rule they have no responsibility to defend or pay claims in existing and threatened construction defect litigation.

Even for projects that are not in litigation, the players are not safe. The statute of repose for construction projects is 10 years. Thus, for projects that were recently completed, there are still ten years of potential exposure for construction defects, carrying with it the threat of litigation that could cost millions of dollars before any claim is made.

Who does this affect? Virtually everyone in the construction industry will be affected by this decision. Contractors *and* owners who paid millions of dollars for CGL or tail policies purchased in order to protect against exactly these types of claims, could find themselves without protection in the event of litigation, or even worse, could find themselves the target of insurance company suits to recover monies paid for past construction defects.

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This problem extends to subcontractors and suppliers providing labor and materials to construction projects, and who can and most always are, sucked into litigation over construction defects. Architects and other designers who are also common participants in such litigation, could find themselves prime targets as the other partiess are no longer insured and can no longer contribute to settlement. Insurance brokers may find themselves targets as well, when disgruntled contractors wonder exactly what products they were sold, and in any event will wonder what products they are still able to sell. In short, without action or changes, this decision is almost certain to put some companies out of business.

So why didn't any of the parties to the case seek certiorari, i.e. ask the Supreme Court to take another look at the decision and render its opinion? Perhaps one of the reasons could be that the two parties arguing the Group Builders case at the ICA level were essentially both insurance companies.

How did this happen? The ICA decision in Group Builders is a surprisingly short decision, given the magnitude of the issue being addressed. It does not appear to square with existing Hawaii appellate law on the issue of what constitutes an "occurrence", and it certainly does not square with the way the construction industry has conducted business. So why didn't any of the parties to the case seek certiorari, i.e. ask the Supreme Court to take another look at the decision and render its opinion? Perhaps one of the reasons could be that the two parties arguing the Group Builders case at the ICA level were essentially both insurance companies. In other words, neither had great financial incentive in seeing the Court's decision reversed.

The construction/insurance coverage group at Damon Key, recognizing that unless *someone* took action, the decision would become the binding law of the land, attempted to generate industry wide action. Working with an astute client who roused his fellow contractors, we represented the General Contractors Association of Hawaii in an attempt to intervene at the Intermediate Court of Appeals in order to request Supreme Court review. Unfortunately, because the GCA was not a party in the underlying action, it was impossible to force the ICA to let us into the case at the appellate level, and these procedural hurdles prevented a further appeal from going forward.

So, for now, the Group Builders case is and remains the law of the land. That does not mean that we are accepting the status quo. The ICA now knows the sea change it has effected through its summary opinion, and review is ongoing for the right "test case" to request review of this matter. We anticipate that, acting with all deliberate speed, a comprehensive case will soon be presented demonstrating how and why the Group Builders case got it wrong, and why it must be reversed. In the meantime, it is up to individual companies to review their current projects, find their vulnerabilities, and address them now, before a claim arises. We will continue our work on this pressing issue and will be updating our clients and friends with progress.

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For more information or questions regarding this article, please call Anna at 531-8031 ext 601 or email her at aho@hawaiilawyer.com or call Mark at 531-8031 ext 628 or email him at mmm@hawaiilawyer.com

Introducing Damon Key's Newest Blogger

The *Record on Appeal* (recordonappeal.com). Associate Rebecca A. Copeland has joined Robert H. Thomas (inversecondemnation.com), Mark M. Murakami (hawaiioceanlaw.com), and Tred R. Eyerly (insurancelawhawaii.com) as a law blogger, covering a range of appellate issues including state and federal case law analysis, current events, and appellate procedure.

Record on Appeal is part of the firm's appellate and dispute resolution practice which focuses on assisting clients if and when a trial court result is taken to a higher court – an appeal filed either by one of our clients or an opposing party. Having attorneys with specialized knowledge and experience in appellate law and practice is an invaluable resource to best serve our clients in this important stage of a case. However, knowledge of appellate law (in addition to the well-honed research and writing skills that appellate lawyers pride themselves in) helps our clients in all levels of a case. At Damon Key, our appellate knowledgeable lawyers (among other tasks) assist by ensuring that error is preserved at trial, writing pre-trial motions, dispositive motions, bench briefs to assist the trial court on important areas of law, and post-trial motions and briefs.

We also have a long tradition of appellate *amicus* practice at Damon Key. An *amicus curiae* ("friend of court") brief is one that is filed on behalf of an individual or group that is not a party to an appeal. An amicus seeks to call to the court's attention interests or arguments which might otherwise escape the court's consideration – but which are important in assessing the issues before the court. Headed by Robert H. Thomas, our lawyers have filed numerous amicus briefs in both state and federal court including the United States Supreme Court in cases involving environmental law, federal jurisdiction, eminent domain, regulatory takings, beach and shoreline law, and water rights.

One of the most recent examples is an amicus brief we filed in the United States Supreme Court in September in *United States v. Tohono O'odham Nation*. Prepared by Robert Thomas, Mark Murakami, Rebecca Copeland, and Christopher Pan, the brief was filed on behalf of the National Association of Home Builders and addressed the impact of a federal jurisdictional statute that dramatically impacts two groups who have claims against the federal government: Indian tribes and property owners. Generally, the issue in this case is whether the statute prevents the filing of a monetary claim against the federal government in the Court of Federal Claims if there is already a claim against the federal government pending in a federal district court that arises from the same operative facts. The Supreme Court heard oral argument in the case on November 1, 2010 and a decision is expected before the end of the term.

Having attorneys with specialized knowledge and experience in appellate law and practice is an invaluable resource to best serve our clients in this important stage of a case. However, knowledge of appellate law (in addition to the well-honed research and writing skills that appellate lawyers pride themselves in) helps our clients in all levels of a case.

Having a presence on the internet through blogging is one of the many ways Damon Key not only keeps others informed on the law, but also allows our lawyers to stay up to date on the latest changes in law. For example, in blogging about appellate issues, Rebecca reads and analyzes cases from the Hawaii appellate courts and courts of appeals throughout the nation. She also keeps up to date on appellate procedure and current events related to the practice of appellate law.

If you are interested in this growing practice, please visit Rebecca's blog at *www.recordonappeal.com*. You can also find Rebecca on Twitter at *@recordonappeal*.

Recent Developments In Hawaii Clean Energy

Christopher Pan

Hawaii relies on imported petroleum to meet almost 90% of its primary energy requirements, making it by far the most oil dependent state in the nation. Hawaii residents pay more for electricity than anyone else in the nation. According to the most recent data, residential and commercial consumers in Hawaii pay 2.5 times the national average for electricity. Every year, Hawaii exports upwards of $5 billion to buy foreign oil, representing about 10% of the gross state product.

It is not surprising, therefore, that Hawaii has established some of the most aggressive goals for renewable energy in the country. Hawaii contains significant renewable energy resources, including solar, wind, biomass, geothermal, hydropower, ocean wave and ocean thermal energy. In 2008, the U.S. Department of Energy and the State of Hawaii established the Hawaii Clean Energy Initiative to decrease the state's dependence on imported oil and increase the use of clean energy—enough to supply 70% of the state's overall energy needs by 2030 (30% through increased efficiency and 40% through indigenous, renewable sources). In 2009, the Hawaii State Legislature enacted this goal into law.

In recent months, a number of developments affecting clean energy generation, production and regulation have occurred.

Decoupling: In August, the Public Utilities Commission (PUC) approved a decoupling mechanism designed to de-link the revenues and profits of the Hawaiian Electric Companies (Hawaiian Electric Company, Hawaii Electric Light Company, and Maui Electric Company) from their electricity sales. Described by the PUC as a "transformational change from traditional rate-making", decoupling overhauls the way electric rates are set for households and businesses in Hawaii.

Under traditional utility regulation, a utility's revenues are linked to the amount of electricity sold. Utilities recover fixed costs and an allowed profit margin partially through fixed customer charges and partially through variable per kilowatt hour charges. Those rates are based largely on the estimated costs of providing service over a set period of time divided by the forecasted amount of sales over that same time period. If actual sales equal the forecast, the utility recovers its fixed costs and its profit margin. If actual sales exceed the forecast, the utility earns extra profit. If actual sales fall below the forecast, the utility earns less profit and may not recover all of its fixed costs. Under conventional regulation, promoting energy efficiency is against the utility's interest as it reduces revenue and undermines its profit.

The PUC recognized that pursuing Hawaii's clean energy goals would contribute to falling sales at the Hawaiian Electric Companies. Decoupling breaks the link between the utility's ability to recover its fixed costs, including its profit margin, from the actual volume of sales that occur, thereby in theory removing the disincentive for the Hawaiian Electric Companies to aggressively pursue investing in renewable energy sources and energy efficiency and conservation.

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Damon Key Leong Kupchak Hastert • 1003 Bishop Street • Suite 1600 • Honolulu, Hawaii 96813
Telephone (808) 531-8031 • Facsimile (808) 533-2242 • Website www.hawaiilawyer.com

Decoupling was first introduced in California in 1982 and has been adopted in about a dozen other states. Under a decoupled system, the PUC will approve a revenue level based on the services it authorizes the Hawaiian Electric Companies to undertake on behalf of customers. Rates are then adjusted based on varying sales levels, allowing the utility to continue recovering the costs of providing those services, but not earn additional profit from higher sales.

Electric Vehicles: Motor vehicles account for roughly 20% of the energy consumed in Hawaii. In October, the PUC approved HECO's pilot Electric Vehicle Charging Rates. The lower rates are designed to encourage early adoption of electric vehicles and incentivize customers to charge their electric vehicles during off-peak hours after 9:00 pm. The three-year pilot program is open to 1,000 customers on Oahu, 300 in Maui County and 300 on Hawaii Island. On Oahu, the electric vehicle charge rate will be about 6 cents per kilowatt hour lower than the standard rate, increasing to 7 to 10 cents per kilowatt hour lower on the neighbor islands. Pilot program participants charging during peak hours will actually pay 3 cents per kilowatt hour more than standard rates.

There are currently also both state and federal incentives to purchase an electric vehicle. Under Hawaii's Electric Vehicle Rebate Program, rebates of up to $4,500 are now available for the purchase of each new, highway-capable electric or plug in hybrid electric vehicles, with up to an additional $500 rebate available for the purchase and installation of each new electric vehicle charger. In addition, a federal tax credit of up to $7,500 is available under the federal Qualified Plug-In Electric Drive Motor Vehicle Tax Credit.

Interisland Cable: In June, the state selected a firm to prepare the environmental impact statement evaluating the effect of installing a high voltage interisland undersea cable system to integrate the electrical systems of the islands of Oahu, Molokai and Lanai. The environmental impact statement is expected to be completed in April 2012 and is the first step in the development process of the interisland cable. The cable would potentially allow the transmission of 400 megawatts of renewable wind energy generated on Molokai and Lanai to Oahu, representing 12% of Oahu's power requirement. If approved, the interisland cable could begin construction in approximately 2015, with early estimates of the cost between $800 million and $1 billion.

Coupled with the implementation of a "feed-in tariff" program and ongoing power purchase agreements, these recent developments continue to expand the exciting opportunities for clean energy in Hawaii.

For more information or questions regarding this article, please call Christopher at 531-8031 ext 614 or email him at cp@hawaiilawyer.com

Did You Know

Question: A liability insurance policy is triggered by an "occurrence," or an accident. Insurance policies usually have policy limits per each occurrence and a higher, general aggregate policy limit. If a manufacture sells a defective product which injures several users of the product, does this constitute one occurrence? Or are there several occurrences, one for each injured user, making the higher, general aggregate policy limit applicable?

Answer: The Hawaii appellate courts have never addressed this issue. Recent cases from Wisconsin and Illinois have held that each injured person experiences an occurrence, so the aggregate policy limit applies.

Damon Key Welcomes Steven Gray

Steven Gray

Damon Key Leong Kupchak Hastert is proud to welcome a new associate and familiar face to our team, Steven Gray. He assisted as our Summer Associate from May to August 2009 where he researched and wrote legal memoranda on various topics, and helped conduct investigations of corporate waste and tax fraud. Upon graduating from the University of Michigan Law School in May 2010, he was as excited to join our team as we were in having him. His law experience and education background will ensure our clients receive the best service, and we can all benefit from his expertise and ideas. Steven recently passed the Hawaii State Bar* Exam as well as the patent bar, and is registered to practice before the United States Patent and Trademark Office (USPTO).

"Damon Key has a fine reputation in town, a compelling history, and great attorneys, and I hope to learn as much as I can," he said. "I like how friendly the staff is and how there is a kind of 'family feel' at the firm."

Born and raised in Salt Lake City, Utah, Steven attended high school there, but also lived in numerous states across the Midwest including Iowa, Michigan, Wisconsin, and Ohio. Before pursuing his law degree, he was very interested in a different field: Science.

"Out of all the subjects in school, I was most fascinated by Physics and Astronomy," he said. "I grew up in a 'science environment' and enjoyed learning about the laws that govern the physical universe and the challenges presented by complex mathematical problems."

Steven earned a Bachelor's of Science, Physics, and Astronomy degree and minored in Business Management and Philosophy at Brigham Young University in Provo, Utah where he graduated with honors. At BYU, he was a recipient of the Academic Scholarship and Hale Family Physics and Astronomy Scholarship. While attending school, he worked as a full-time Verified Rights Owners Program (VeRO) Specialist for eBay in Draper, Utah, where he was responsible for processing Notices of Claimed Infringement (NOCI) from various companies, addressing concerns from Intellectual Property rights owners and eBay members, and monitoring Spanish and Italian websites. eBay paid for part of his school tuition. It was then when he decided to pursue law.

At the University of Michigan, he served as a member of the Intellectual Property Students Association (IPSA), J. Reuben Clark Law Society (JRCLS), Wolverine Street Law Association, International Law Students Association (ILSA), and the Native American Law Students Association (NALSA). He also participated in the prestigious Giles Sutherland (IP) Moot Court, where he and his partner were selected from eight teams to represent the University of Michigan Law School at the regional level. Steven was a recipient of numerous scholarships and recognition including the Potter Stewart Scholarship, which covered one-third of his law school tuition.

Steven's experience includes a legal internship position at Federal Signal, where he researched and wrote legal memoranda, conducted research, conducted audits of business units' trademarks and service marks, participated in negotiations with a competitor company in patent infringement, helped design the company's new unsolicited ideas program, and participated in the development of the company's construct legal risk assessment tool.

He also served as a Legal Extern at the Native Hawaiian Hospitality Association (NAHHA) where he researched 501(c)(3) tax laws and worked with the IRS to update the organization's status, created form contracts for services rendered and received, and updated the bylaws and articles of incorporation to reflect the organization's changes.

In his free time, Steven enjoys spending time outdoors. He is an Eagle Scout who is fluent in Spanish, and enjoys playing basketball, soccer, tennis, and rugby.

**pending license issuance*

Damon Key's Luncheon and Wine Tasting

Luncheon with guest speaker Governor Linda Lingle at the Pacific Club.

East meets West Wine Tasting at Damon Key's office.

Damon Key Leong Kupchak Hastert • 1003 Bishop Street • Suite 1600 • Honolulu, Hawaii 96813
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Legal Alert is published periodically by Damon Key Leong Kupchak Hastert to inform clients of legal matters of general interest. It is not intended to provide legal advice or opinion.

Attorneys in the News

Christi-Anne Kudo Chock and **Robert H. Thomas** were on the faculty of "Integrating Water Law and Land Use Planning," a one day conference on the intricacies of Hawaii water law on November 19th. Christi-Anne led a session on "Hawaii Water Rights – Where Culture and the Law Merge," and Robert spoke about "Water Rights, Property Rights and the Law of Settled Expectations."

Tred R. Eyerly's blog insurancelawhawaii.com was recently selected in the top 50 insurance blogs for 2009 by Lexis/Nexis.

Mark M. Murakami spoke on the topic of "Agricultural Landowner Liability to Trespassers" at the Hawaii Farm Bureau Federation's Annual Convention at the Royal Hawaiian Hotel on October 20th. He also taught a Business Law 200 class at Kapiolani Community College in November.

Douglas C. Smith is one of four attorneys from the HSBA who have been invited by the Department of Taxation, State of Hawaii to be part of a task force to help the state agency shape Hawaii's policy and procedure regarding the new Hawaii estate tax.

Robert H. Thomas was featured in a recently-published book on attorney use of social media. social.lawyers: Transforming Business Development, 2010 ed. Robert also moderated a panel of experts on beach law at the ABA Annual Meeting in San Francisco.