

# THE POLICYHOLDER ADVOCATE

April 2008



## Internet Resources

- Associated General Contractors of America, State-by-State Survey (Feb. 2007), *Insurance Coverage for Construction Defects*: [http://www.agc.org/cs/industry\\_topics/construction\\_risk\\_management/insurance\\_coverage\\_for\\_construction\\_defects](http://www.agc.org/cs/industry_topics/construction_risk_management/insurance_coverage_for_construction_defects)
- Wielinski & Young, *New Challenges to Insurance Coverage for Defective Construction*: [http://findarticles.com/p/articles/mi\\_qa4023/is\\_200601/ai\\_n17180871](http://findarticles.com/p/articles/mi_qa4023/is_200601/ai_n17180871)

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## FIVE STATE SUPREME COURTS WEIGH IN ON COVERAGE FOR FAULTY CONSTRUCTION CLAIMS

By Linda J. Karpel

Commercial general liability (“CGL”) policies are designed to cover a broad range of liabilities faced by commercial policyholders. Increasingly, state Supreme Courts have been called upon to determine whether those insured liabilities include claims for faulty construction.

In the past, courts have adopted numerous approaches in resolving that issue. Those courts following the true intent of the policy language and drafting history conclude that faulty construction claims *can* constitute an insured “occurrence,” with coverage turning on the applicability of various policy exclusions. Other courts hold that faulty construction claims are *never* covered, because they do not constitute insured “occurrences.” Still other courts conclude that faulty construction claims may constitute an “occurrence,” *but only if* that construction leads to damage to third-party property; if not, there is no “occurrence” and no possibility of coverage.

Within the past year, five state Supreme Courts, in Arkansas, South Carolina, Florida, Texas and Tennessee, addressed CGL coverage for faulty construction claims involving property damage only to the building or home at issue. Happily for policyholders, four of the five Courts found coverage, or at least a possibility of coverage. The remaining state Supreme Court, in Arkansas, found no coverage for faulty construction in the same situation.

The Arkansas Court, in Essex Insurance Co. v. Holder, No. 07-803, 2008 WL 598160 (Ark. Mar. 6, 2008), held that a family’s claims against a contractor-policyholder for faulty construction did not constitute an “accident,” and was therefore not an “occurrence” triggering coverage under the contractor’s CGL insurance policy. While the Arkansas Supreme Court recognized that the term “accident” was not defined in the insur-

ance policy at issue, it found no ambiguity, having previously defined an accident as “an event that takes place without one’s foresight or expectation.” The Arkansas Court found cases like those discussed below non-persuasive. Rather, the Court held that,

Faulty workmanship is not an accident; instead, it is a foreseeable occurrence.

\* \* \* \*

Accordingly, we hold that defective workmanship standing alone-resulting in damages only to the work product itself- is not an occurrence under a CGL policy such as the one at issue here.

### Id.

In contrast, four days later, the Supreme Court of South Carolina reached the opposite conclusion in Auto Owners Insurance Co. v. Newman, No. 26450, 2008 WL 648546 (S.C. Mar. 10, 2008). In Newman, a homeowner sued Trinity Construction for breach of contract, breach of warranty and negligence, in connection with the faulty installation of stucco by Trinity’s subcontractor. The South Carolina Supreme Court affirmed the trial court’s ruling that the claims against Trinity were covered by insurance, although the relevant property damage was limited to the house at issue.

In addressing the Newman claim, the South Carolina Court stressed that the negligent installation of stucco by the subcontractor did not, in itself, constitute an “occurrence” that might trigger coverage. However, the Court concluded that the continuous intrusion of water into Ms. Newman’s home, resulting in substantial damage to the

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framing and exterior sheathing of the house, qualified as an “accident” involving “property damage” to property that was not the subcontractor’s work product-- in short, an “occurrence.” The South Carolina Court rejected the insurer’s argument that coverage for the claims against Trinity was barred by the “expected or intended” policy exclusion. The Court refused to believe that Trinity expected or intended that its subcontractor would install the stucco negligently, and, therefore, concluded that Trinity could not have expected or intended the damage that resulted.

The Florida Supreme Court also spoke out on faulty construction or “workmanship” in United States Fire Insurance Co. v. J.S.U.B., Inc., No. SC05-1295, 2007 WL 4440232 (Fla. Dec. 20, 2007). J.S.U.B. involved claims by homeowners of damage to the foundations, drywall and interior portions of their homes, due to the use of poor soil and improper soil compaction by the subcontractors hired by J.S.U.B., the contractor-policyholder. The Florida Supreme Court overturned the trial court’s judgment for the insurer and held that the subcontractor’s defective soil preparation constituted an “occurrence,” with associated “property damage.”

In J.S.U.B., the Court rejected several popular arguments by insurers that are often made in such cases, including the following:

(a) *The argument that damages from faulty workmanship are probable, foreseeable and can “never” constitute an “occurrence.”* The Court stated,

[W]e fail to see how defective work that results in a claim against the contractor because of injury to a third party or damage to a third party’s property is “unforeseeable,” while the same defective work that results in a claim against the contractor because of damage to the completed project is “foreseeable [and therefore not an ‘occurrence’].” This distinction would make the definition of “occurrence” dependent on which property was damaged.

J.S.U.B., 2007 WL 4440232, at \*9.

(b) *The argument that, unlike a tort claim, a contractor’s alleged breach of contract can never result in an “accident” or “occurrence.”* The Court stated,

[T]here is nothing in the basic coverage language of the current CGL policy to support any definitive tort/contract line of demarcation for purposes of determining whether a loss is covered by the CGL’s initial grant of coverage.

“Occurrence” is not defined by reference to the legal category of the claim. The term “tort” does not appear in the CGL policy.

Id. at \*10 (quotation omitted).

(c) *The argument that faulty construction or workmanship which damages only the work product does not result in “property damage.”* The Court stated,

[J]ust like the definition of the term “occurrence,” the definition of “property damage” in the CGL policies does not differentiate between damage to the contractor’s work and damage to other property.

We further reject [the insurer’s] contention that there can never be “property damage” in cases of faulty construction . . . . To the contrary, faulty workmanship or defective work that has damaged the otherwise non-defective completed project has caused “physical injury” to tangible property within the plain meaning of the policy.

Id. at \*14.

Ultimately, the J.S.U.B. Court recognized that, while CGL policies often do not cover contract claims resulting from faulty or defective construction, “this is by operation of the CGL’s business risk exclusions, not because a loss actionable only in contract can never be the result of an ‘occurrence.’” Id. at \*11 (quotation omitted). In J.S.U.B., the business risk exclusions potentially applicable, for [Damage to] “Your Work” and “Your Property,” contained exceptions which reinstated coverage for the claims at issue.

The Texas Supreme Court decided similarly in Lamar Homes, Inc. v. Mid-Continent Casualty Co., 242 S.W.3d 1 (Tex. 2007). Lamar involved claims by a couple against a homebuilder concerning defects in the foundation of their home that caused their sheetrock and stone veneer to crack. The Texas Court addressed the same issues -- does defective construction that damages only the contractor’s work product



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(the home) constitute an “occurrence” or “property damage?” The Texas Court answered those questions in the same way as the Florida Supreme Court: “yes” and “yes.” In doing so, the Court clarified that both a breach of contract and the negligent performance of a deliberate act can constitute “accidents” amounting to “occurrences.” Among other things, the Court clarified also that the distinction between tort and contract damages is not material to the determination of coverage under a CGL policy:

Contrary to the carrier’s contentions, the CGL policy makes no distinction between tort and contract damages. The insuring agreement does not mention torts, contracts, or economic losses; nor do these terms appear in the definitions of “property damage” or “occurrence.” The CGL’s insuring agreement simply asks whether “property damage” has been caused by an “occurrence.” Therefore, any preconceived notion that a CGL policy is only for tort liability must yield to the policy’s actual language.

Lamar, 242 S.W.3d at 13.

The Supreme Court of Tennessee weighed in on the same issues in Travelers Indemnity Co. of America v. Moore & Associates, Inc., 216 S.W.3d 302 (Tenn. 2007). There, a contractor sought coverage for claims by a hotel for damage and deterioration of the hotel’s wall structures from water penetration caused by negligent window installation. The Texas Court did not hesitate to conclude that the claims constituted an “occurrence” with associated “property damage.” In doing so, the Court rejected the insurer’s argument that the claims were not an “occurrence” because the damage to the hotel was a foreseeable consequence of negligent window installation, rather than an “accident.”

We therefore conclude that the term “accident” as used in the CGL in this case [in “occurrence” definition] means “an unforeseen or unexpected event.” Furthermore, we consider foreseeability from the perspective of the insured.

\* \* \* \*

We are unpersuaded that the foreseeability of damages should be determined under an assumption that the windows would be installed improperly. If foreseeability is determined from the negligent completion of the project, then the negligent acts of the insured will almost never be “accidents”

because, by definition, negligence requires that damages be foreseeable . . . . We decline to adopt a construction of “accident” which would so drastically limit the coverage under a CGL.

\* \* \* \*

Assuming that the windows would be installed properly [the alleged water penetration was not foreseeable and] the alleged water penetration is both an “accident” and an “occurrence” for which there is coverage under the “insuring agreement.”

Moore, 216 S.W.3d at 308, 309 (citations omitted). Recognizing that coverage for claims which meet the requirements of an insurance policy’s insuring agreement may still be precluded by an exclusion, the Texas Court addressed the “Your Work” exclusion, which would have been applicable, had an exception not reinstated coverage in situations where the work at issue was performed by a subcontractor.

The highest state courts of South Carolina, Florida, Texas and Tennessee got it right. There is nothing in the insuring agreement of the standard CGL policy to suggest that a claim for faulty construction does not constitute an insured “occurrence.” Indeed, the various exclusions for a policyholder’s defective work and products suggest that claims for faulty construction are insured “occurrences.” Those exclusions would be unnecessary if it were otherwise. Policyholders should be encouraged by this trend of policyholder-friendly decisions in this vital area of insurance coverage.



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