

Strafford

Presenting a live 90-minute webinar with interactive Q&A

Occurrences in Construction Defects Claims: Triggering Coverage and Interpreting Exclusions Under CGL Policies

Navigating Divergent Court Views to Maximize Coverage or Limit Liability

THURSDAY, FEBRUARY 23, 2017

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Christopher C. French, Visiting Assistant Professor of Law, **Penn State Law School**,
University Park, Pa.

Carl A. Salisbury, Partner, **Bramnick Rodriguez Grabas Arnold & Mangan**,
Scotch Plains, N.J.

Britton D. Weimer, Founding Partner, **Weimer & Weeding**, Bloomington, Minn.

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 10.**

Tips for Optimal Quality

FOR LIVE EVENT ONLY

Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-866-871-8924** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail sound@straffordpub.com immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press *0 for assistance.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

Continuing Education Credits

FOR LIVE EVENT ONLY

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 35.

Program Materials

FOR LIVE EVENT ONLY

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.



CARL A. SALISBURY

csalisbury@jonbramnick.com

Carl Salisbury leads the Commercial Litigation and Insurance Recovery Group at Bramnick, Rodriguez, Grabas, Arnold & Mangan. He has more than 25 years of experience in the litigation and trial of complex commercial disputes. In addition to handling general commercial matters, Mr. Salisbury has more than 25 years of courtroom and trial experience in complex commercial insurance cases and has represented the full gamut of companies in disputes involving large insurance claims, from small and middle-market corporations, condominium associations, restaurants, and non-profit institutions, to Fortune 100 companies. He has helped corporate policyholders recover for insurance claims involving environmental pollution, workplace discrimination, bodily injuries and property damage, mold contamination, construction defects, and a variety of other commercial disputes.

He received his law degree at Wake Forest University School of Law, where he was Managing Editor of the *Wake Forest University Law Review*. He also served as a judicial clerk to the Hon. Reynaldo G. Garza on the United States Court of Appeals for the Fifth Circuit. He is admitted to practice in New York; New Jersey; the U.S. District Court for the District of New York; the U.S. District Court for the District of New Jersey; the U.S. Court of Appeals for the Third Circuit; and the Supreme Court of New Jersey.

I'm Setting the Table



We're Talking About "Property Damage"

- "Property Damage" means:
- "(1) physical injury to or destruction of tangible property which occurs during the policy period, including loss of use thereof at any time resulting therefrom, or
- (2) loss of use of tangible property that has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period."

Occurrence Coverage

- What is an “occurrence?”
 - Typical policy definition: “An accident, including continuous or repeated exposure to substantially the same general harmful conditions.”
 - But what is an “accident”?
 - Usually undefined, but often considered to be an event that is “unintended” and “unexpected.”
 - Is “defective construction” unexpected?

The Occurrence Issue

- Two main lines of case authority:
 - If the damage is the unintended result of faulty workmanship, it is an “accident” and a potentially covered “occurrence.”
 - If the damage is construction-related, it is the result of an intentional act and therefore not an “occurrence.”
- What about “mistakes”/ negligent workmanship?

The *Port Imperial* Case

- “The accidental nature of an occurrence is determined by analyzing whether the alleged wrongdoer intended or expected to cause an injury. If not, then the injury is accidental, even if the act that caused the injury is intentional.”

Port Imperial Condominium Association, Inc. v. K Hovnanian Port Imperial Urban Renewal, Inc., HUD-L-2054-08.

The Business Risks Exclusions

- Three flavors:
 - Damage to Property
 - Damage to Your Product
 - Damage to Your Work

“Damage to Property” Exclusion

- The insurance does not apply to: “That particular part of real property on which you or any contactors or subcontractors working directly or indirectly on your behalf are performing operations.”
- The insurance does not apply to: “That particular part of your property that must be restored, repaired or replaced because ‘your work’ was incorrectly performed on it.”
- **Key exception:** The “Damage to Property” exclusion does **not** apply to “property damage” included in the “products-completed operations hazard.”

Products Completed-Operations Hazard

- Appears in “Definitions” section of the CGL policy.
- If bodily injury or property damage occurs away from premises the contractor owns or rents and arises from the contractor’s faulty workmanship or product, then the damage is covered under the “products-completed operations hazard.”
- Covers damage caused by a contractor’s faulty construction or workmanship once the work is complete, *e.g.*, after the contractor delivers the fully constructed building to the owner.

“Damage to Your Product” and “Damage to Your Work” Exclusions

- “Damage to Your Product”: Insurance does not cover “‘Property damage’ to ‘your product’ arising out of it or any part of it.”
- “Damage to Your Work”: Insurance does not cover “‘Property damage’ to ‘your work’ arising out of it or any part of it and included in the ‘products-completed operations hazard.’”
- ***Key Exception:*** Exclusion does not apply if the damage or the work out of which the damage arises was performed by a subcontractor.

Fitting the Pieces Together

- “The risk intended to be insured is the possibility that the goods, products or work of the insured, once relinquished or completed, will cause bodily injury or damage to property other than to the product or completed work itself, and for which the insured may be found liable.”
- Questions to answer to determine if there is coverage:
 - Is the damage an “accident” from the standpoint of the insured?
 - Has the building been delivered to the Owner or put to its intended use?
 - Was the defective construction allegedly the fault of a subcontractor?



Occurrences in Construction Defects Claims: Triggering Coverage and Interpreting Exclusions Under CGL Policies

**Strafford Webinar
Christopher French
February 23, 2017**



Christopher French

ccf11@psu.edu

(814) 867-0395

Background

- Visiting Assistant Professor of Law at Penn State Law School
- Former Partner at K&L Gates (1991-2012)

Background

- Tried cases in federal and state courts in 7 states (both first party and third party policies)
- Neutral and Party-Appointed Arbitrator
- Expert Witness (retained by both insurers and policyholders)

EDUCATION

J.D., Harvard University, 1991 (*cum laude*)

B.A., Columbia University, 1988



Courts' Determinations of Whether Construction Defects Are “Occurrences”

- Christopher French, *Construction Defects: Are They Occurrences?* 47 Gonz. L. Rev 1 (2011) (can be downloaded here:
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1904577)
- Christopher French, *Revisiting Construction Defects as “Occurrences” under CGL Insurance Policies*, 19 U. Pa. J. Bus. L. 101 (2016) (can be downloaded here:
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2800149)
- U. Penn article updated the Gonzaga article through the late fall of 2016
- Approximately 20 significant state supreme or intermediate appellate court and federal appellate court decisions were decided between 2011 and 2016 (other relevant decisions also have been issued but they do not change the law)

The *Weedo* Case

- *Weedo v. Stone-E-Brick, Inc.*, 405 A.2d 788 (N.J. 1979)
- Subcontractor applied Stucco to a house poorly
- Cracked and had to be replaced

The *Weedo* Case

- Policy at issue contained 1973 standard form “business risk” exclusions
- Court held no coverage
- Court viewed claims essentially as breach of warranty claims

The *Weedo* Case

- Court reasoned that the policyholder/contractor should be responsible for satisfying customers
- Court relied upon a 1971 law review article by Professor Roger Henderson
- Professor Henderson's law review article was based upon the 1966 business risk exclusions, not the definitions of "occurrence" or "property damage"

The *Weedo* Case

- Court never discussed whether faulty workmanship was an “occurrence”
- Court never analyzed whether faulty workmanship constituted “property damage” or caused property damage
- Business risk exclusions were redrafted in 1986 to reduce their scope

The *Weedo* Case

- *Weedo* has been mistakenly followed by several courts
- *Weedo* was effectively overruled last summer by *Cypress Point Condo. Assocs. v. Adria Towers, LLC.*, 143 A.3d 273 (N.J. 2016)
- “Distinguished” *Weedo* on the basis it was based upon the superseded 1973 business risk exclusions and it did not address the “occurrence” or “property damage” issues

The Case Law Since *Weedo*

- Majority rule is that construction defects can be occurrences
- Supreme Courts of Alabama, Alaska, Connecticut, Florida, Georgia, Indiana, Iowa, Kansas, Minnesota, Mississippi, Montana, New Jersey, North Dakota, South Carolina, South Dakota, Tennessee, Texas, West Virginia, and Wisconsin have held in favor of policyholder
 - *See* U. Penn article, pp. 123-24 for list of cases

The Case Law Since *Weedo*

- Since 2012, North Dakota and West Virginia have joined the majority position most favorable to policyholders (includes defective workmanship itself)
- North Dakota – *K&L Homes, Inc. v. American Family Mut. Ins. Co.*, 829 N.W. 2d 724 (N.D. 2013)
- West Virginia – *Cherrington v. Erie Ins. Prop. and Cas. Co.*, 745 S.E. 2d 508 (W.Va. 2013)

The Case Law Since *Weedo*

- At least four states have passed statutes that effectively mandate that construction defects are occurrences. *See* Ark. Code Ann. § 23-79-155(9) (Supp. 2011); Colo. Rev. Stat. § 13-20-808(3) (2010); Haw. Rev. Stat. § 431-1 (2011); S.C. Code § 38-61-70 (2011)
- Pro-insurer holdings in Arkansas (overruled by statute in 2011 but now in flux), Kentucky and Pennsylvania
 - *Columbia Ins. Grp., Inc. v. Cenark Project Mgmt. Servs., Inc.*, 491 S.W. 3d 135 (Ark. 2016) (without discussing the inconsistent statute, concluded that claims for breach of warranty due to faulty workmanship are not covered under CGL policies)



Courts Holding Construction Defects Are Occurrences

- Unless policyholder expected or intended its work to be defective, construction defects including the defective workmanship itself are occurrences
- *See* U. Penn article, pp. 126-128 for list of cases



Courts Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Emerging majority rule
- *See* U. Penn article, pp. 128-134 for list of cases
- Basic reasoning is that policyholder did not expect or intend for property separate from its work to be damaged
- Questionable reasoning with respect to defective workmanship itself because the contractor does not expect or intend its work to be defective



Courts Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Supreme Court of Florida's decision in *United States Fire Ins. Co. v. J.S.U.B., Inc.*, 979 So.2d 871 (Fla. 2007) is a leading example of a decision in this camp



Courts Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Court rejected the insurer's arguments one by one
- Does not matter if it is foreseeable that the work was defective
- Damages resulting from a breach of contract can be an accident



Courts Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Allowing recovery does not turn insurance policies into performance bonds
 - Performance bonds guarantee completion of project
 - Performance bonds cover owner of property, not contractor



Courts Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Contractors cannot effectively control quality of subcontractor's work, so allowing insurance recovery does not encourage contractor or subcontractor to do sloppy work
- Definition of "property damage" does not distinguish between damage to the contractor's or subcontractor's work versus damage to other property



Courts Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- *Weedo* involved different business risk exclusions so it is of no precedential value
- The existence of business risk exclusions proves construction defects are occurrences
 - Exclusions would be unnecessary otherwise

Recent Decisions Holding Construction Defects Are Occurrences if Property Other Than The Work At Issue Was Damaged

- Alabama – *Town & Country Property, LLC v. Amerisure Ins. Co.*, 111 So. 3d 699 (Ala. 2012) (damage to property separate from the faulty workmanship itself is covered but not the faulty work itself); *Shane Traylor CabinetMaker, LLC v. American Resources Ins. Co.*, 126 So. 163 (Ala. 2013) (same); *Owners Ins. Co. v. Jim Carr Homebuilder, LLC*, 157 So. 3d 148 (Ala. 2014) (same)
- Connecticut – *Capstone Building Corp. v. American Motorists Ins. Co.*, 67 A. 3d 961 (Conn. 2013) (same)
- Georgia – *Taylor Morrison Services, Inc. v. HDI-Gerling America Ins. Co.*, 746 S.E. 2d 587 (Ga. 2013) (same)

Recent Decisions Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Illinois – *Lagestee-Mulder, Inc. v. Consolidated Ins. Co.*, 682 F. 3d 1054 (7th Cir. 2012) (under Illinois law, damage to property other than the defective workmanship itself can constitute an “occurrence”)
- Iowa – *Nat’l Sur. Corp. v. Westlake Inv., LLC*, 880 N.W.2d 724 (Iowa 2016) (faulty workmanship that causes damage to property other than the defective workmanship itself is covered)

Recent Decisions Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- Ohio – *Westfield Ins. Co. v. Custom Agri Systems, Inc.*, 979 N.E.2d 269 (Ohio 2012) (subcontractor’s defective work is not covered, but implied separate property damage caused by defective work is covered)
- New Jersey – *Cypress Point Condo. Assocs. v. Adria Towers, LLC.*, 143 A.3d 273 (N.J. 2016) (finding that consequential damages caused by subcontractor’s defective workmanship are “property damage” caused by an “occurrence”)
- New Mexico – *Pulte Homes of New Mexico v. Lumbermens Ins.*, 2015 WL 9263675 (N.M. Ct. App. Dec. 17, 2015) (faulty workmanship that causes damage to property other than the defective workmanship itself is covered)



Recent Decisions Holding Construction Defects Are Occurrences If Property Other Than The Work At Issue Was Damaged

- South Carolina – *Crossman Communities of North Carolina, Inc. v. Harleysville Mut. Ins. Co.*, 736 S.E.2d 651 (S.C. 2012) (upholding the constitutionality of statute defining “occurrence” to include damage caused by defective work going forward); *Auto-Owners Ins. Co. v. Rhodes*, 748 S.E. 2d 781 (S.C. 2013) (holding the removal of defective signs was an occurrence).



Courts Holding Construction Defects Are Not Occurrences Because They Are Not “Accidents”

- *See* U. Penn article, p. 135-140
- Sixth Circuit has issued 2 recent decisions applying Kentucky law
 - *McBride v. Acuity*, 510 Fed. Appx. 451 (6th Cir. 2013) (under Kentucky precedent, construction defects are not “occurrences”)
 - *Liberty Mutual Fire Ins. Co. v. Kay & Kay Contracting LLC*, 545 Fed. Appx. 488 (6th Cir. 2013) (same)



Courts Holding Construction Defects Are Not Occurrences Because They Are Not “Accidents”

- Pennsylvania Supreme Court decision in *Kvaener Metals Division of Kvaener U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888 (Pa. 2006)
- Coke oven battery constructed defectively



Courts Holding Construction Defects Are Not Occurrences Because They Are Not “Accidents”

- Undefined term “accident” means “unexpected,” which implies more fortuity than is present in a construction defect situation
- Court did not explain what evidence, if any, supported a finding that the contractor expected or intended its work to be defective

Courts Holding Construction Defects Are Not Occurrences Because They Are Not “Accidents”

- Court relied on Professor Henderson’s 1971 article, which was based upon the 1966 business risk exclusions
- Court did not analyze business risk exclusions at issue



Courts Holding Construction Defects Are Not “Occurrences” Because The Damages Are The Foreseeable Consequences Of Intentional Acts

- The reasoning of decisions such as *Kvaener* is unsound because it is often foreseeable that damages may result from negligence
 - That is reason people/companies buy insurance



Courts Holding Construction Defects Are Not “Occurrences” Because The Damages Are The Foreseeable Consequences Of Intentional Acts

- For example, people buy auto insurance because they know that accidents happen and, when they do, damage results
 - That does not mean they intend to cause the accidents that do occur



Courts Holding Construction Defects Are Not “Occurrences” Because The Damages Are The Foreseeable Consequences Of Intentional Acts

- *Kvaener* may be ripe for a challenge in light of dramatic shift in the law favorable to policyholders
- *Indalex Inc. v. Nat’l Union Fire Ins. Co. of Pittsburgh*, 99 A.3d 926 (Pa. 2014) (court declined to hear appeal of decision where court held insurer’s duty to defend was triggered by a construction defect claim)



Occurrences in Construction Defect Claims: A Logical Approach

Britton D. Weimer

Partner, Weimer & Weeding PLLC

bweimer@weimerweeding.com

Britton D. Weimer

bweimer@jonesatre.com

- Partner in commercial litigation firm of Weimer & Weeding in Minneapolis.
- AV-rated attorney with over 28 years in commercial insurance coverage and defense.
- Principal author of the *CGL Policy Handbook* (Wolters Kluwer, 2nd Edition 2012) and *Minnesota Insurance Law and Practice* (Thomson West, 2nd Edition 2010).





Construction Claims: Principal Occurrence Issue

Most common occurrence issues in construction coverage litigation: whether faulty workmanship is an “accident.”

Usually turns on: **accidental act vs. accidental damage.**

Faulty workmanship

Is faulty workmanship an “accident”
i.e. an “occurrence”? Case law
undeveloped and conclusory in most
states.

Many cases, seeking simple rule,
conflate the occurrence trigger with
the property, work, product and
intentional-damage exclusions.



Analysis must begin with policy language

Most of the case law is self-referential, citing older cases from same or other jurisdictions.

Problem: much of the case law traces back to cases pre-dating significant changes in 1986 ISO form.



1986 revision: Significant shift

A CGL "occurrence" is by definition an "accident." But does this mean an accidental act or accidental damage?

Through 1986, ISO definition of "occurrence" did include an accidental-damage component — "an accident...which results...in bodily injury or property damage neither expected nor intended from the standpoint of the insured."



1986 revision: Significant shift

1986 brought a significant change: ISO removed the expected/intended damage language from the occurrence definition, placing it in a new intentional-damage exclusion.

The exclusion uses the same language: bodily injury or property damage “expected or intended from the standpoint of the insured.”



1986 revision: Significant shift

Continue reading an expected/intended damage prohibition into the occurrence requirement? Renders the intentional-damage exclusion a nullity.

Insurance policies should be read as a whole, harmonizing all provisions. A construction should be avoided that makes the exclusion superfluous.



1986 revision: Significant shift

Thus, under plain language of post-1986 ISO, only issue for “occurrence” trigger is whether the insured’s **act** was accidental.

Whether the damage was accidental, expected or intended is irrelevant now to occurrence, and should be examined solely under exclusion.



1986 revision: Significant shift

Thus, for “occurrence,” focus in construction cases should be whether the insured **believed** its work was **defective**.

Unfortunately, most courts continue to employ the pre-1986 ISO accidental-damage analysis.



JSUB's Flaw

Nationwide, coverage attorneys rely upon the Florida Supreme Court's CGL coverage analysis in *U.S. Fire Ins. Co. v. J.S.U.B.*, 979 So.2d 871 (Fla. 2007). In general, the Court's analysis is thorough and logical. In particular, it makes a sound distinction between the occurrence trigger and the business-risk exclusions.

JSUB's Flaw (2)

Unfortunately, *JSUB* did not examine the accidental-act issue afresh. Instead, it cited *State Farm Fire & Casualty Co. v. CTC Development Corp.*, 720 So.2d 1072 (Fla. 1998), which cited *Dimmitt Chevrolet, Inc. v. Southeastern Fidelity Ins. Corp.*, 636 So.2d 700 (Fla. 1993), which cited *Jackson Township Mun. Utils. Auth. v. Hartford Accident & Indem. Co.*, 451 A.2d 990 (N.J. Law. Div. 1982) ("occurrence" means "accidental damages"). Of course, the 1982 New Jersey case was not construing the post-1986 ISO CGL!



Conflating Accident and Damage

Many cases cause further confusion by conflating the occurrence trigger with the work-product exclusions: (1) damage to insured's work and product is *never* an "occurrence," but (2) damage to third party's property is *always* an occurrence:

- "[C]onstruction defects that damage something other than the project itself will constitute an 'occurrence' under a CGL policy." *CMK Dev. Corp. v. West Bend Mut. Ins. Co.*, 917 N.E.2d 1155, 1164 (Ill. Ct. App. 2009).



Conflating Accident and Damage

- “We conclude property damage caused by faulty workmanship is a covered occurrence to the extent the faulty workmanship causes bodily injury or property damage to property other than the insured’s work product.” *Acuity v. Burd & Smith Constr., Inc.*, 721 N.W.2d 33 (N.D. 2006).

Again, confuses occurrence trigger with exclusions.



Conflating Accident and Damage

These cases (and many others) focus on what *property* is damaged. Correct analysis for the *property, work and product exclusions*. However, not correct analysis for the *occurrence trigger*.

The *property, work and product exclusions* examine whether the damages sought by the plaintiff are damages to the insured's own work product. If so, the exclusions bar coverage; if not, the exclusions do not apply.



Accidental acts: Practical result

Conclusion: The occurrence trigger has no necessary relationship to whose property was damaged, and whether that damage was accidental. It simply examines whether the **defect** was an “accident.”

Subcontractor insureds perform the same tasks over and over, and usually know if they are violating industry standards.

Practical result: Faulty work by subcontractors often does not satisfy “occurrence” trigger.



Second trend: Fact pleading

The shift from “accidental damage” to “accidental act” is **one** reason insureds cannot satisfy “occurrence” trigger.

Second reason: Shift from legal pleading to factual pleading.



Fact-Based Pleading Requirement

Two recent U.S. Supreme Court decisions clarified: **only fact-based pleadings are relevant.**

Conclusory legal labels are irrelevant. See *Bell Atlantic Corp. v. Twombly*, 127 S.Ct. 1955 (2007); *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009).



Fact-Based Duty to Defend

Long before *Iqbal* and *Twombly*, perceptive courts were already taking fact-based approach to defense. See Couch on Insurance, Third Edition (“It is the factual allegations instead of the legal theories alleged which determine the existence of a duty to defend”).



Presumption of Occurrence?

If there is a conclusory allegation of **negligence** against construction professional, is there a presumption that the **act** was accidental – i.e. an occurrence?

Better view: no. Two reasons:



No Occurrence Presumption

First, the insured has the burden of proof on the occurrence trigger.

Thus, absent contrary facts, it should be presumed that there was *no* occurrence.



No Occurrence Presumption

Second, construction professionals are classic example of people who are **not** surprised by defective work:

- A stucco person, roofer, etc. does same work hundreds of times, and knows the industry standards for their specialty.
- When they do work below industry standards, that defect is likely not accidental.



Rationale for Presumption

“We hold that the definition of ‘accident’ required to establish an ‘occurrence’ ... cannot be satisfied by claims based upon faulty workmanship. Such claims simply do not present the degree of fortuity contemplated by the ordinary definition of ‘accident’...” *Kvaerner Metals Div. v. Commercial Union Ins. Co.*, 908 A.2d 888, 899 (Pa. 2006).

While *Kvaerner* is stated as an absolute rule, it should more accurately be treated as a presumption, rebuttable by facts pled.



Conclusion: No-Occurrence Presumption

Correct analysis: Absent special facts showing the defect was a true surprise to insured, no duty to defend subcontractor insureds in construction-defect cases.