BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
White and Williams LLP
Randy J. Maniloff
maniloffr@whiteandwilliams.com

And the winner is…

See below for the results of the *Binding Authority* Caption Contest.

April 16, 2011

A Rare Occurrence: PA Policyholder Wins A Faulty Workmanship (*Kvaerner*) Case

And Here's To You Robinson Fans; Heaven Holds A Place For Those Who Pray

Anyone who has been involved in insurance coverage in Pennsylvania over the past few years might think that such a headline is as believable as Kim Jong Il's golf score. It is no secret that, since the Pennsylvania Supreme Court's 2006 decision in *Kvaerner*, policyholders in Pennsylvania that have sought coverage for defective workmanship (whether construction defect or otherwise) have fared about as well as the Pirates. The Western District of Pennsylvania recently ended the policyholder drought. But while this headline is true, a close look at the decision shows that the worm has hardly turned for policyholders confronting the faulty workmanship/"occurrence" issue.

In *National Fire Ins. Co. of Hartford v. Robinson Fans*, the court addressed coverage for an insured, Robinson Fans, that designed, manufactured and sold three industrial fans to Archer-Daniel-Midlands Co. ADM filed suit against Robinson Fans alleging that the equipment "failed catastrophically" on account of design defects. *Robinson Fans* at 1. The insurer undertook Robinson's defense under a reservation of rights. At issue before the court in the subsequent coverage action was summary judgment on whether the failure of a defective product was an "occurrence." *Id.* at 2.

The court readily acknowledged that, under *Kvaerner*, "the definition of 'accident' required to establish an 'occurrence' under the policies 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' or its common judicial construction in this context. To
hold otherwise would be to convert a policy for insurance into a performance bond. We are unwilling to do so, especially since such protections are already readily available for the protection of contractors." *Id.* at 5 (quoting *Kvaerner*).

The *Robinson Fans* court also concluded that, based on other decisions it examined, Pennsylvania law does not recognize the applicability of a CGL policy to a breach of contract claim. *Id.* With that as a backdrop, the court then distinguished *Kvaerner*, and

other cases that have followed *Kvaerner*, from the defective fans before it. The decision's money paragraph is as follows:

[T]here is a discernible distinction between a product that actively malfunctions, which could give rise to an "accident," and flawed product related work done in performance of a contract, which cannot. Cases suggest a material difference between a claim that stems from a "breach[] [of] duty imposed by mutual consensus" -- or an alleged failure to live up to bargained-for standards -- and one that stems from breaches of standards of care imposed by law as a matter of social policy, independent of the parties' bargain. See CPB Int'l, 2007 U.S. Dist. LEXIS 86506, at *19. The former constitutes uncovered "contractual claims of poor workmanship," even if couched as negligence; the latter, however, may be a covered "active malfunction." Cf. Erie Ins. Exchange v. Abbott Furnace Co., 972 A. 2d 1232, 1238 (Pa. Super. Ct. 2009) (emphasis in original). In other words, negligent or defective design, in a case in which the product is designed pursuant to and in accordance with a contract, is necessarily part and parcel of the contract performance. In contrast, if a product was negligently or defectively designed, and then supplied pursuant to a subsequent contract, the design work might be measured against tort standards of care rather than agreed-upon terms.

Id. at 6-7 (emphasis added).

The *Robinson Fans* court then cited several decisions that it believed supported this distinction The take-away from the court's rule is this:

If the failure of the insured's work or product was caused by the insured's faulty design, and its obligation of proper design was one that the insured undertook in its contract, then the insured breached its contract and any damage was not caused by a occurrence.

On the other hand, if the failure of the insured's work or product was caused by the insured's faulty design, and such design predated the contract, *i.e.*, was not an obligation undertaken specifically on account of the contractual relationship, then the insured did not breach its contract, but, rather, breached a duty imposed by social policy. In this case, any damage was caused by a occurrence.

Turning the facts at issue, the *Robinson Fans* court held as follows:

Here, the underlying complaint states a claim entitled, "negligence in design." In so doing, it avers that the insured "agreed to provide" equipment that conformed with ADM's performance specifications; "designed" the equipment, at some unspecified point in the case chronology; and "selected materials for and manufactured the equipment." Further, the complaint states that the "negligence" and "design defects" caused "catastrophic failure" of the equipment. The complaint lacks any factual allegation that the insured undertook to design the equipment pursuant to mutual consensus or agreement, or instead, for example, supplied a fan designed long before Robinson and ADM contracted. Therefore, there is no basis for decisively concluding either that the

complaint alleges failure to exercise care in duties imposed by contract, or those imposed extra-contractually by law. One possibility is equally as likely as the other.

Id. at 10.

While *Robinson Fans* was a win for the policyholder, it does not turn Pennsylvania law on its head.

First, it was a duty to defend decision. The court made clear that its decision was tied to a broad duty to defend standard and that when it comes to any potential indemnity obligation, the result may be much different. The court stated: "I cannot rule out the possibility that something other than faulty workmanship is blamed for the equipment failure. Therefore, because I must liberally construe the underlying complaint in favor of the insured, I conclude that it possibly pleads a triggering "occurrence," rather than faulty workmanship." *Id.*

Second, even if the failure of the fans constitutes an occurrence, for indemnity purposes, because it is determined that the design work predated the contract, *i.e.*, the contract was not for the design, it seems likely that coverage would still be precluded by the "your product" exclusion (or "your work" exclusion in other contexts).

Third, faulty workmanship cases are more likely to involve construction defects alleged against contractors, which are not as likely to have design components, but, rather, allege failure to perform work as promised, *i.e.*, the breach of contract claim that *Robinson Fans* held is not an occurrence (although now look out for "artful pleading" to trigger a duty to defend).

Fourth, in reaching its decision, the court relied on two New Jersey decisions and two Pennsylvania decisions that pre-dated *Kvaerner*.

A curious aspect of the *Robinson Fans* opinion is footnote 6: "Moreover, while the faulty workmanship alone is not covered, faulty workmanship that causes an accident may lead to coverage. *L-J, Inc. v. Bitumous Fire and Marine Insurance Co.*, 567 S.E. 2d 489, 492-493 (S.C. 2002)." This statement suggests that the *Robinson Fans* court never received the *Gambone* memo. Further, South Carolina law has come a long way since *L-J*, especially after the recent *Crossman* decision. South Carolina is probably the last state that should be cited these days when attempting to make any pronouncement of coverage for faulty workmanship.

Please let me know if you have any questions.

And now to the *Binding Authority* Caption Contest…

First, thank you to all of you who entered. The response was overwhelming and the entries were excellent. This is the part where I make the obligatory statement that it was so hard to pick a winner and I wish everyone could have won.

Before getting to the winner, a few honorable mentions.

While she was not eligible to win on account of the White and Williams "employee rule," Gale White's entry was fantastic. **"WHAT, Maniloff's coverage book is $125!"**

Another that poked fun at the book: "OMG…I hit the wrong key and deleted my bootlegged copy of "General Liability Insurance Coverage: Key Issues In Every State."

Several people felt that I could be influenced by flattery (normally, yes, easily so) as there were many entries that incorporated nice things about *Binding Authority*. Here are a couple:

"But I just left the courtroom! How did Maniloff issue a *Binding Authority* on my case already?"

"Live streaming video of *Binding Authority*! What will this guy think of next?"

And the winner is… See attached for the fantastic entry from **Brad Spicer** of **Cincinnati Insurance Company.** It is short, simple and says it all when assigning an insurance related caption to that photo. Congratulations to Brad. A copy of **"General Liability Insurance Coverage: Key Issues In Every State"** is already on its way to him. Click here to order (only 3 copies left in stock as of this moment).

Thanks again to everyone who entered. I have a bunch more copies of the book here and am working on an idea for another contest (contest ideas gladly accepted).

Please let me know if you have any questions.
Randy

Randy J. Maniloff
White and Williams LLP
1800 One Liberty Place | Philadelphia, PA 19103-7395
Direct Dial: 215.864.6311 | Direct Fax: 215.789.7608
maniloffr@whiteandwilliams.com