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Sweet Carolina For Insurers: Good Times Will Never Seem So Good For Construction Defect Claims

South Carolina Supreme Court Significantly Limits The Scope Of CD Coverage

I've always wanted to visit South Carolina. Right now South Carolinians are probably nodding their heads as they imagine the state's many world class attractions that, of course, I've been longing to see all these years. Who wouldn't be, they're thinking. While I'm sure South Carolina has a few of those, my long-standing desire to visit the Palmetto state has nothing to do with its beautiful beaches, or anything related to spacious skies or purple mountains majesties. None of that.

My dream trip to South Carolina dates back to when I was a kid, growing up in Philadelphia. I had a friend who went on an annual family vacation to Florida by car. [Imagine that – 20 hours in the car, with your family, back in the day before everything came with headphones.] And every year my friend came back from his trip and regaled us with stories and tales of this magical land, along the road to Florida -- a place that the natives called "South of the Border." It sounded like paradise. Yet I could never really understand exactly what this roadside oasis was all about. It had its name as its location. How could that be? All I knew was this – If you went to South of the Border you could buy two things -- fireworks and bumper stickers that said "South of the Border."

Now, many years later, I'm still just as intrigued by and not exactly sure what South of the Border is. As best I can tell you can still buy a lot of fireworks there and the place makes Niagara Falls look like the Avenue des Champs-Élysées. One of these days I will make a pilgrimage to this world-famous roadside tourist attraction and pay my respects to its ambassador, Pedro, and slap a bumper sticker on the back of the Toyota (well, maybe not that).

Speaking of fireworks [OK, work with me here, it's the segue to the insurance coverage part], that is certainly the impact that the South Carolina Supreme Court's recent decision in *Crossman Communities v. Harleysville Mutual Insurance Company* will have on the world of construction defect coverage. Where do you even begin with this one?

Putting aside, for the moment, the substance and rule of law adopted in *Crossman*, the opinion oozes with irony. On one hand, the Supreme Court of South Carolina does a good job of describing the national landscape concerning coverage for construction

defect. Its conclusion, after reviewing the various schools of thought adopted by courts, is that "[t]he result is an intellectual mess." *Crossman* at 4. And the court is right.

[For a further look at this intellectual mess, discussing in detail, and comparing and contrasting, how all 50 states have addressed coverage for construction defects, *see* Randy Maniloff and Jeffrey Stempel, "General Liability Insurance Coverage – Key Issues In Every State," Oxford University Press, 2011, at 221-245. To keep *Binding Authority* as a free publication, it will now be periodically interrupted with an advertisement. Just pretend you are watching TV.]

http://www.us.oup.com/us/catalog/general/subject/Law/?view=usa&ci=9780195381511#Description

So how did the South Carolina Supreme Court respond to this intellectual mess? By adopting its own approach (and one that has shades of Pennsylvania's "Gambone" approach), and, in the course of doing so, overruling in part a decision that it issued a mere 16 months ago. Something tells me that overruling an infant opinion, and, in doing so, no doubt throwing the state's construction defect coverage disputes into helter-skelter, is not the way to solve an "intellectual mess."

Crossman is a complex opinion and anyone involved in this area will need to read the opinion (for me -- more than once) to fully appreciate it. But, in general, here is the crux. At issue was the availability of coverage for a general contractor for defects in the construction of condominiums that were discovered a few years after their completion. The underlying claims resulted in a $16.8 million settlement.

The Crossman Court examined the national landscape concerning coverage for construction defects before turning to South Carolina law. For that one must look at L-J, Inc. v. *Bituminous Fire and Marine Ins. Co.*, 621 S.E.2d 33 (S.C. 2005) and *Auto Owners Ins. Co., Inc. v. Newman*, 684 S.E.2d 541 (S.C. 2009).

In L-J, the South Carolina Supreme Court held that "because the claim was merely one for damages to repair [a] defective roadway, there was no occurrence and no coverage. We did, however, leave open the possibility that a CGL policy may provide coverage in cases where faulty workmanship causes damage to other property, and in Newman, we had the opportunity to address that issue." Id. at 6. In *Newman*, the South Carolina high court held that, while "defective application of … stucco did not on its own constitute an occurrence, the continuous moisture intrusion resulting from the subcontractor's negligence was an occurrence." Id. at 7.

The *Crossman* Court now overruled *Newman* to the extent that "it permitted coverage for faulty workmanship that directly causes further damage to property in the absence of an 'occurrence' with its fortuity underpinnings." Id. at 10.

In its place, the court adopted the rule that "where the damage to the insured's property is no more than the natural and probable consequences of faulty workmanship such that the two cannot be distinguished, this does not constitute an occurrence." Id. at 9.

Applying this rule to the case before it, the *Crossman* Court held that coverage was unavailable:

Applying an 'occurrence' as embracing the definition of 'accident' with its fortuity component, we hold the damage here was not caused by or the result of an 'occurrence.' The homeowners' complaints allege Respondents negligently designed, developed and constructed the condominium units and breached the express and implied warranties that the project would be constructed free of defects. The homeowners asserted that they suffered 'injuries and damages in the amount equal to the extraordinary repair, maintenance, and reconstruction costs required and expended and to be expended in the future over the expected life of the structure, loss of use, and diminution in value.' The natural and expected consequence of negligently installing siding to these condominiums is water intrusion and damage to the interior of the units. There is no fortuity element present under this factual scenario."
Id.

The rationale for the court's decision was that *Newman* examined "occurrence" without regard to the fortuity component of an "accident" and, instead, focused on moisture intrusion as a continuous or repeated exposure to substantially the same harmful conditions as an unexpected happening or event not intended by the contractor. Id. at 7.

The up-shot of *Crossman* is that it will now be much more difficult for insured-general contractors to trigger coverage for damage to their own, non-defective work, based on the "sub-contractor exception" to the "your work" exclusion. In many cases, the damage to the non-defective work (such as, caused by water intrusion) will simply not have the requisite fortuity to qualify as having been caused by an accident, and, therefore, an "occurrence." Likewise, for the same reason, it will now be much more difficult for all insureds -general contractors or subcontractors -- to trigger coverage for damage to other property (such as the building/home owners personal property) that was caused by faulty workmanship.

[To fully appreciate all of this one needs to read the actual opinion and certain hypothetical claim scenarios that the court examined in arriving at its conclusion.]

Will other courts around the country chose to follow *Crossman*? That's always the unknown question after a unique decision from a state supreme court.

Lastly, for those dealing with construction defect claims under Pennsylvania law, and Gambone issues, the *Crossman* opinion may provide some guidance.

A copy of the South Carolina Supreme Court's January 7, 2011 opinion in *Crossman v. Harleysville* can be accessed here:

http://www.judicial.state.sc.us/opinions/displayOpinion.cfm?caseNo=26909

Please let me know if you have any questions.
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